

**THE FUTURE OF SOCIAL SECURITY FOR THIS  
GENERATION AND THE NEXT: IMPLICATIONS  
OF PROPOSALS AFFECTING FEDERAL, STATE,  
AND LOCAL GOVERNMENT EMPLOYEES**

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**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON SOCIAL SECURITY  
OF THE  
COMMITTEE ON WAYS AND MEANS  
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

MAY 21, 1998

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EMPLOYEES**

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**THURSDAY MAY 21, 1998**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON WAYS AND MEANS,  
SUBCOMMITTEE ON SOCIAL SECURITY,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 10 a.m., in room B-318, Rayburn House Office Building, Hon. Jim Bunning (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

# *ADVISORY*

FROM THE COMMITTEE ON WAYS AND MEANS

## **SUBCOMMITTEE ON SOCIAL SECURITY**

FOR IMMEDIATE RELEASE

CONTACT: (202) 225-9263

May 13, 1998

No. SS-16

### **Bunning Announces Ninth Hearing in Series on "The Future of Social Security for this Generation and the Next"**

Congressman Jim Bunning (R-KY), Chairman, Subcommittee on Social Security of the Committee on Ways and Means, today announced that the Subcommittee will hold the ninth in a series of hearings on "The Future of Social Security for this Generation and the Next." At this hearing, the Subcommittee will examine the implications of proposals affecting Federal, State, and local government employees. These proposals include extending mandatory Social Security coverage to all newly hired State and local employees, and altering current law provisions affecting the Social Security benefits of persons who receive government pensions. The hearing will take place on Thursday, May 21, 1998, in room B-318 Rayburn House Office Building, beginning at 10:00 a.m.

In view of the limited time available to hear witnesses, oral testimony will be from invited witnesses only. Witnesses are expected to include Members of Congress, the U.S. General Accounting Office, Federal and State government employee representatives, and social insurance experts. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

#### **BACKGROUND:**

Numerous Social Security reform proposals include a provision to extend mandatory coverage to all newly hired State and local government employees. Social Security coverage has been expanded since Social Security's beginning. Workers in business and industry, then about 60 percent of the workforce, were the only persons covered in the initial Social Security Act of 1935. Over time, the program's coverage has grown to include the self-employed, nonprofit groups, agricultural and household workers, the Armed Services, Members of Congress, and all other Federal employees hired after 1983.

State and local governments were excluded altogether in the original Social Security Act of 1935 to avoid raising the possible constitutional questions of whether the Federal Government could tax State and local governments, and because many State and local government employees were already covered under other pension plans. Beginning in 1950, Congress amended the law several times to make participation in Social Security available on a voluntary basis to employees of State and local governments. In 1983, the State and local government option to terminate Social Security coverage was repealed and all State and local governments participating in the system were required to continue their participation. Beginning July 1, 1991, Social Security coverage was made mandatory for State and local government workers who do not participate in a retirement system for such employment.

The Social Security Administration estimates that 96 percent of the workforce, including 70 percent of State and local government workers, is now covered by Social Security and that about 4.9 million State and local government workers are not cov-

ered by Social Security. Seven States (California, Colorado, Illinois, Louisiana, Massachusetts, Ohio, and Texas) account for over 75 percent of non-covered payroll. Previous surveys have found that police, firefighters, and teachers are more likely to occupy non-covered positions.

Also impacting Federal, State, and local government employees are two current law provisions that reduce entitlement to Social Security benefits. These provisions, commonly known as the Government Pension Offset (GPO) and Windfall Elimination Provision (WEP), were enacted in 1977 and 1983, respectively, in an attempt to provide Social Security benefits which are fair to all workers, whether they work in non-Social Security-covered government employment or in jobs under Social Security.

Since the enactment of the GPO and WEP, government workers have expressed concern that benefit reductions are imprecise and unfair. Legislative proposals have been introduced which modify the way benefits would be calculated.

In announcing the hearing, Chairman Bunning stated: "Most Americans are surprised to learn that not all workers are covered by Social Security. To many, covering those State and local government workers not covered under Social Security is an issue of simple fairness. Yet, changing the retirement systems of many of our teachers, firefighters, and police forces could have far reaching effects on these workers and the long-term financing of their retirement plans. These workers have devoted their careers to us, ensuring the safety and sound education of ourselves and our children. Their views are very important to this Subcommittee, and we need to listen and carefully consider what they have to say."

#### **FOCUS OF THE HEARING:**

The Subcommittee will receive views on proposals to extend mandatory Social Security coverage to all newly hired State and local government employees and altering current law provisions affecting the Social Security benefits of persons who receive government pensions.

#### **DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:**

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label, by the close of business, Thursday, June 4, 1998, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Social Security office, room B-316 Rayburn House Office Building, at least one hour before the hearing begins.

#### **FORMATTING REQUIREMENTS:**

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.
2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.
3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments

by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at '[HTTP://WWW.HOUSE.GOV/WAYS\\_MEANS/](http://WWW.HOUSE.GOV/WAYS_MEANS/)'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

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Chairman BUNNING [presiding]. The Subcommittee will come to order.

I want to let all of our people that are going to testify know that there is going to be a vote called very, very shortly on the floor of the House. So, I'm going to adjourn, because the first two panelists are Members, and they will be coming back with me, I hope, to testify, and then we will get on with all other testimony. We have a very long program, a lot of people that wanted to testify today. So if you'll bear with us for just a short period of time, we have a journal vote over on the floor, and I'll be back immediately. So, we'll stand in recess until I get back.

[Recess.]

Chairman BUNNING. The Subcommittee will come to order.

I'm going to do my opening statement and when Ms. Kennelly comes we'll allow her to do hers even though we may have to interrupt some of our testimony.

Today marks our ninth hearing in a series of the future of Social Security for this generation and the next. The Subcommittee will examine the implications of proposals affecting Federal, State, and local government employees. These proposals including extending mandatory Social Security coverage to all newly hired State and local employees and altering current law provisions affecting the Social Security benefits of persons who receive government pensions.

Most Americans are surprised to learn that not everyone pays FICA, Federal Insurance Contributions Act, taxes and receives Social Security benefits and believe it's only fair for State and local government employees to pay the same FICA taxes that most everyone else does. Perhaps, that is why just about every proposal for Social Security reform, including the recommendations of the 1994-96 Social Security Council, includes a provision to extend mandatory coverage to all newly hired State and local government employees.

The Social Security Administration estimates that about 5 million State and local government workers are not covered by Social



Security. Seven States—California, Colorado, Illinois, Louisiana, Massachusetts, Ohio, and Texas—account for more than 75 percent of these workers. Yet, changing the retirement system of many of our teachers, firefighters and police force could have a far-reaching effect on these workers, their employees, and the long-term financing of their respective retirement plans. These workers have devoted their careers to us ensuring our safety and educating our children. Their views are very important to this Subcommittee, and we intend to listen carefully to what they have to say.

Also impacting Federal, State, and local government employees are two current law provisions that reduce entitlement to Social Security benefits. These provisions commonly known as the GPO, government pension offset, and WEP, windfall elimination provisions, were enacted in 1977 and 1983, respectively, in an attempt to provide Social Security benefits which are fair to all workers whether they work in jobs covered by Social Security or jobs that are not covered by Social Security.

As we consider major Social Security reform, we have the opportunity to closely examine those current law benefit provisions which have come under scrutiny. Since the enactment of the GPO and the WEP, government workers have expressed concern that benefit reductions are imprecise and unfair. Today, we'll hear more details regarding these concerns and the legislative proposals introduced which would modify the way benefits would be calculated.

Let me emphasize that the purpose of this hearing series is to fully explore all options for Social Security reform so that when the time comes Members will be able to make informed decisions fair to all workers and all generations. We seek information. We do not seek to establish any particular position. Today, we look forward to hearing the views from all our witnesses, particularly those who have been or will be personally affected by these proposals.

I reserve time for the Ranking Member, and I will go immediately to our first panel and the gentleman from Louisiana, Mr. Jefferson, and all Members can submit for the record any opening statements that they might have.

Mr. Jefferson.

**STATEMENT OF HON. WILLIAM J. JEFFERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF LOUISIANA**

Mr. JEFFERSON. Thank you very much, Mr. Chairman and Members of the Subcommittee, and I thank you for the bipartisan show of support this morning by providing me with my own statement, thank you.

I'm pleased to have the opportunity to testify before the Subcommittee regarding the government pension offset. This issue is totally separate from the question of whether FICA should apply to hires or not, because if it were to start today in that direction, it still wouldn't fix the issue that we now have which has cropped up over the years of reliance under another system, so I don't have to state a position one way or another on that to talk about this issue which still needs fixing.

After the 1935 act was established, some of local governments decided to remain outside of the system as you pointed out. It's estimated that about 4.9 million State and local government employ-

ees are not covered by Social Security and, as you pointed out, many of them are in 7 States.

Many of the State and local government employees that are covered by government pension will be unfairly affected by the pension offset. As you may be aware, the pension offset was originally enacted in response to perceived abuses to the Social Security system resulting from the Goldfarb decision. The Social Security system provides that if a spouse who worked and paid into Social Security died, the benefits were to be paid to the surviving spouse as a survivor benefit. Men were required to prove dependency on their spouses before they became eligible for Social Security benefits. There was no such requirement for women. The Goldfarb decision eliminated this different treatment of men and women. The court, instead, required Social Security to treat men and women equally by paying benefits to either spouse without regard to dependency. Many of the men who would benefit from the Goldfarb decision were also receiving large government pensions. It was believed that these retirees would bankrupt the system receiving government and private pensions in addition to survivor benefits.

To combat this perceived problem, pension offset legislation was enacted in 1977. The legislation provided for a dollar for dollar reduction of Social Security benefits to spouses or retiring spouses who received earned benefits from the Federal, State, or local retirement system. The pension offset provisions can affect any retiree who receives a civil pension on Social Security but primarily affects widows or widowers eligible for survivor benefits.

In 1983, the pension offset was reduced to two-thirds of the public employees survivor benefit. It was believed that one-third of the pension was equivalent to pension available in the private sector. The pension offset, which was aimed at higher paid government employees also applies to public service employees who generally receive lower pension benefits, and this is the nub of the problem. These public service employees include secretaries, school cafeteria workers, teacher aids, teachers, and others who don't receive high salaries. The pension offset as applied to this group is punitive, unfairly harsh, and bad policy. While government pensions were tailored to produce benefits that were equal to many combined, private pension and Social Security benefits for upper level government workers, this was not true for low-income workers such as the employees I mentioned.

To illustrate the harsh impact of the pension offset, consider a widow who retired from the Federal Government and received a civil service annuity of \$550 monthly. The full widows benefit is \$385. The current pension offset law reduces the widow's benefit to \$19 a month—two-thirds of the \$550 civil service annuity which is \$367—this is then subtracted from the \$385 widows benefit, leaving only \$19. The retired worker receives \$569 instead of almost \$1,000 otherwise.

Proponents of the pension offset claim that the offset is justified because survivor benefits were intended to be in lieu of pensions, however, if this logic was followed across the board, people with private pension benefits would also be subject to an offset but this is not the case. While Social Security benefits of spouses or surviving spouses earned in government pensions are reduced by two for

every \$3 earned, Social Security benefits of spouses or surviving spouses earning private pensions are not subject to offset at all.

My office has received letters from around the country including one from a 68-year-old lady, Helen Emery from Fair Oaks, California, who writes to say that "My government retirement, monthly, after deductions, is a very modest \$988.69. I'm sure you know this is just a fraction above the poverty level. The government pension offset benefits will reduce my Social Security benefits and only allow me an additional \$116 per month." These sorts of letters come from people who work for sheriff's departments and from people who work for other agencies that I've noted in my statement—I do not have time, apparently, to go through them all.

But I do want to point out that in this Congress I've introduced H.R. 2273. There are 161 or 162 cosponsors on the bill. It's a bill that has a great deal of support. Senator Mikulski has introduced a similar bill in the Senate. It limits the pension offset to those—person to collect more than \$1,200 in overall pension benefits. As you can see H.R. 2273 has a cap on it, so it doesn't go to the high benefit pensioners, but it will affect those small people who were never, I don't believe, intended to be affected by the GPO, and it corrects, I think, an inequity in the system.

So, I would urge the Subcommittee to take up this legislation in the remaining part of this session and—as it goes about the business of fixing the overall system, making sure that the system is fair to everyone, that it take into account this issue which is a very important issue, this many people around the country have a great deal of interest in. I thank the Subcommittee for listening to me. I appreciate your giving me the time.

[The prepared statement follows:]

**Statement of Hon. William J. Jefferson, a Representative in Congress from the State of Louisiana**

Mr. Chairman and members of the Subcommittee, I am pleased to have the opportunity to testify regarding the Government Pension Offset (Pension Offset).

I thank the Chairman for having a hearing on this pressing issue. Pension Offset is an important issue to me. It is an important issue for my constituents in Louisiana and it is an important issue for many state and local government employees across the nation.

As you are aware, state and local government employees were excluded from Social Security coverage when the Social Security System was first established in 1935. These employees were later given the option to enroll in the Social Security System and in the 1960's and 1970's many public employees opted to join in.

Some local governments chose to remain out of the system. Their employees and spouses planned for retirement according to the rules in effect. It is estimated that about 4.9 million state and local government employees are not covered by Social Security. Seven states (California, Colorado, Illinois, Louisiana, Massachusetts, Ohio and Texas) account for over 75 percent of non-covered payroll.

Many of the state and local government employees that are covered by government pensions will be unfairly affected by the Pension Offset.

As you may be aware, the Pension Offset was originally enacted in response to the perceived abuses to the Social Security system resulting from the *Goldfarb* decision.

The Social Security System provides that if a spouse who worked and paid into Social Security died, the benefits were to be paid to the surviving spouse as a survivor benefit. Men were required to prove dependency on their spouses before they became eligible for Social Security survivor benefits. There was no such requirement for women.

The *Goldfarb* decision eliminated the different treatment of men and women. The court instead required Social Security to treat men and women equally by paying benefits to either spouse without regard to dependency.

Many of the men who would benefit from the *Goldfarb* decision were also receiving large government pensions. It was believed that these retirees would bankrupt the system, receiving large government and private pensions in addition to survivor benefits.

To combat this perceived problem, Pension Offset legislation was enacted in 1977. The legislation provided for a dollar for dollar reduction of Social Security benefits to spouses or retiring spouses who received earned benefits from a federal, state or local retirement system. The Pension Offset provisions can affect any retiree who receives a civil service pension and Social Security but primarily affects widows or widowers eligible for survivor benefits.

In 1983, the Pension Offset was reduced to two-thirds of the public employer survivor benefit. It was believed that one-third of the pension was equivalent to the pension available in the private sector.

The Pension Offset aimed at high paid government employees also applies to public service employees who generally receive lower pension benefits. These public service employees include secretaries, school cafeteria workers, teachers aides and others low wage government employees. The Pension Offset as applied to this group is punitive, unfairly harsh and bad policy.

Government pensions were tailored to produce benefits that were equal to many combined private pension-Social Security policies in the private sector for upper level government workers. However, this was not true for lower income workers such as employees who worked as secretaries, school cafeteria workers, teachers aides and others who generally receive lower pension benefits.

To illustrate the harsh impact of the Pension Offset, consider a widow who retired from the federal government and receives a civil service annuity of \$550 monthly. The full widow's benefit is \$385. The current Pension Offset law reduces the widow's benefit to \$19 a month ( $\frac{2}{3}$  of the \$550 civil service annuity is \$367, which is then subtracted from the \$385 widow's benefit, leaving only \$19). The retired worker receives \$569 (\$550 + \$19) per month.

Proponents of the Pension Offset claim that the offset is justified because Survivor benefits were intended to be in lieu of pensions. However, were this logic followed across the board, then people with private pension benefits would be subject to the offset as well. But that is not the case.

While Social Security benefits of spouses or surviving spouses earning government pensions are reduced by \$2 for every \$3 earned, Social Security benefits of spouses or surviving spouses earning private pensions are not subject to offset at all.

If retirees on private pensions do not have Social Security benefits subject to offset, why should retirees who worked in the public service?

The Pension offset has created a problem that cries out for reform. It will cause tens of thousands of retired government employees, including many former para-professionals, custodians or lunch room workers, to live their retirement years at or near the poverty level.

My office has received numerous calls, all from widows, who are just getting by and desperately need some relief from the Pension Offset.

*The following is a letter we received from Helen J. Emery from Fair Oaks, California.*

I am a 68 year old and worked 27 years for the Government. My government retirement monthly after deductions is a "very" modest \$988.69. I am sure you know this is just a fraction above poverty level. The "windfall" benefits law reduced my social security benefits and only allows me an additional \$116.00 per month even though I alone paid into this Social Security prior to working for the Government.

Effective January 1998, I became a divorced widow and the "offset" effecting my \$724.80 widows Social Security benefits brings my widow's benefits to zero.

I am hoping and praying that you will continue to fight this very unjust "offset" law.

*Millard J. Downing from Wallingford, PA wrote:*

I am retired from the Agency for International Development with a \$12,000.00 a year annuity and through employment outside of federal service have become eligible for Social Security, age 62. Upon visiting my local Social Security Office I was advised that normally I would be eligible for \$425.00 month. However, due to the present Pension Offset and being a federal annuitant, my social security annuity will be reduced to approximately \$207.00 month. I do not consider this reduction as being a fair game when all deductions for above were made while being employed outside of federal service.

*Patricia C. Cook from Metairie, LA wrote:*

I get a small pension from the Jefferson Parish Sheriff's Office (\$473.00) and because of this my Soc. Sec. Check is offset by half. I should receive close to \$500.00 a month that I put in many years of my life for and it is cut to \$243.00. I would appreciate what ever you can do about this and I hope someone will change the other off set also. When I paid my personal Soc. Sec. They grabbed; but when it comes to getting it back, its another story.

During the 104th Congress, I introduced the Government Pension Offset Repeal Bill, H.R. 2167. I have re-introduced this important legislation in the 105th Congress as H.R. 2273.

The legislation, does not completely repeal the Pension Offset, but provides a modification to a complete repeal. It will allow pensioners and widows affected by Pension Offset provisions to receive a minimum \$1200 per month before offset provisions could be imposed. The bill has 162 recorded cosponsors. A corresponding Senate bill, sponsored by Senator Barbara A. Mikulski (D-MD), was introduced in November of 1997.

H.R. 2273 has been referred to this committee, and I urge my colleagues to support this legislation.

Mr. Chairman, I urge the Committee to take up this legislation in the remaining days of the session.

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Chairman BUNNING. If you will remain, I'm going to let Ms. Kennelly make her opening statement, and we would like to do some questions if we can.

Mr. JEFFERSON. Thank you.

Mrs. KENNELLY. Thank you, Mr. Chairman, and thank you for the courtesy of allowing me to make my statement at this moment.

In 1995, the Social Security Advisory Council recommended that all newly-hired State and local employees be covered under Social Security, and I believe today's hearing is the first forum in which State and local employees have had the opportunity to express to us their views on the proposal, and I thank the Chairman for calling this hearing.

As we know, 90 percent of all workers are covered under Social Security. Only 70 percent of State and local workers are covered under the program. Workers who are not covered are unevenly distributed among the States. Seven States account for over 75 percent of the noncovered workers. With this unequal distribution, it is important that we take a careful look at both the impact on individual workers and the financial impact on States and localities. We need to ask whether the benefits for individuals increase or decrease, and we need to ask whether the cost to States will rise. We will hear some of those answers today.

We will also be looking at proposals to change the windfall elimination provision and the government pension offset. These provisions were enacted in an effort to assure consistent benefit treatment between those who paid Social Security and those who did not. It is argued, however, that both of these provisions unfairly reduce Social Security benefits for individuals who have worked in the government employment.

Several of distinguished colleagues, as Mr. Jefferson has just done, will testify, and I look forward to hearing that testimony. Thank you, Mr. Chairman.

Chairman BUNNING. Thank you.

Bill, can I just refer to your bill that you have in, H.R. 2273?

Mr. JEFFERSON. Yes.

Chairman BUNNING. How do you pay for the offset or how do you propose to pay out of the trust funds for the offset or do you just intend to use the trust funds to pay the offset without any way to increase the trust funds? Obviously, these people are already on their own pensions, so they're already retired.

Mr. JEFFERSON. Yes. The bill doesn't propose to treat that question, but it presumes that the answer is contained within the overall system. We know it costs additional money, perhaps, \$200 million according to some estimates but a little less according to others. It's a good deal of money, but it is not so much money that it's out of bounds to be considered to be done. It leaves a lot of people who had expectations of a different outcome in their retirement years suffering in their retirement years even though they had a spouse who worked the entirety of their lives. I don't have the complete answer to how we would fund it, but we're coming to grips, still, with how much it costs. It's somewhere within the range I've spoken of, I'm confident.

Chairman BUNNING. Are you talking about \$200 million out of the trust funds every year to take care of everyone that's offset?

Mr. JEFFERSON. Yes.

Chairman BUNNING. In other words, that's the total cost annually out of the trust funds to take care of 100 percent of the offsets?

Mr. JEFFERSON. Yes. In the context of the bill, the bill limits it to \$1,200.

Chairman BUNNING. In other words, up to \$1,200.

Mr. JEFFERSON. That's right. If you let everybody go it would be much more, but since we put a cap on it, yes, sir, that is the result.

Chairman BUNNING. We'll take a look at the bill for sure, and we may even have a hearing on the bill to see, because that amount of dollars to take care of the people that are being offset—for lack of a better word—ought to be looked at, and I guarantee you that we will take a look at the bill.

Mr. JEFFERSON. Well, I thank you very much for that.

Chairman BUNNING. Barbara, do you have some questions?

Mrs. KENNELLY. Just to follow up—

Chairman BUNNING. You have a friendly question in mind. [Laughter.]

Mrs. KENNELLY. Yes.

Chairman BUNNING. Not that the Chairman's wasn't friendly.

Mrs. KENNELLY. Obviously, we are addressing the issue of saving of Social Security and reform of Social Security, and it's becoming an important issue. While we are discussing reform you would expect that the issue you have raised would be addressed as part of the bigger reform question.

Mr. JEFFERSON. That's correct. And as I said starting out, this is totally different from the question of whether you should start today requiring everyone to pay into a FICA system. This is a relic of the old system where people weren't required to do that. They made other choices, and that needs to be addressed.

Mrs. KENNELLY. And you want to put that to rest.

Mr. JEFFERSON. Yes.

Mrs. KENNELLY. Thank you, Mr. Jefferson.

Chairman BUNNING. J.D.

Mr. HAYWORTH. Thank you, Mr. Chairman. I just want to thank my colleague from Louisiana, because I'm a cosponsor of his legislation and happy to help out with your testimony this morning in trying to get copies together.

Mr. JEFFERSON. Thank you, J.D.

Mr. HAYWORTH. Thank you very much. Nothing else, Mr. Chairman.

Chairman BUNNING. Mr. Frank, would you like to begin.

**STATEMENT OF HON. BARNEY FRANK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS**

Mr. FRANK. Thank you, Mr. Chairman. Thank you for alerting me to the impending vote when I ran into you and saving me from coming down. I appreciate the courtesy when we bumped into each other.

I am a supporter of the legislation sponsored by my colleague from Louisiana, and I also am a sponsor, myself, of a bill that deals with the windfall elimination provision. Let me begin by saying the bill I have introduced has full effects for people whose combined benefits with the passage of the bill would be \$2,000 a month or less, and it would phase out at \$3,000 a month. So, if this is a windfall for people who are making—trying to live in this society on \$18,000, \$19,000 or \$20,000, it is not much of a windfall, and what we have are people who I think are being unfairly picked. They worked at the jobs at the time they worked at them, and they qualified for this combination of Social Security and pension and were then told after their working years, in some cases, or toward the end of them that they were going to suffer this reduction.

I understand it to have been aimed at people who would be getting a windfall because they made a lot of money in one job and then just sneaked in the effect under Social Security, and that's why there is another piece of legislation our colleague from Texas, Mr. Sandlin, has which would eliminate the program entirely.

Mine is narrower than that, and while it does affect most of the people, it does hit most of the people who would be affected by the formula—I'm told 93 percent—I think that shows, in effect, this is not a windfall for people who are rolling in dough, because this is for people with \$3,000 or less, and it is only fully applicable for people who make \$2,000 or less.

The Social Security Administration has said it would cost \$3.4 billion over the next 5 years. I believe that we have the revenues to fix this up and essentially we're talking about people who when they went to work were told this is what they were going to get, and it does seem to me particularly when we're talking about people whose total income is less than \$24,000 a year that we ought to give it to them.

Chairman BUNNING. OK, Mr. Frank. Let me ask you this: Everybody that is covered under the windfall has paid into the Social Security system?

Mr. FRANK. Yes, these are people who worked—

Chairman BUNNING. So, you're proposing to eliminate the total windfall in your—

Mr. FRANK. No, actually, Mr. Sandlin has a bill that would repeal it all together which I'd vote for. Mine is a compromise al-

though it does cover most of the people. It would totally eliminate it for people who make less than \$2,000, and it would phase it out till \$3,000, so it's a complete fix for people under \$2,000; partial as you get close to \$3,000, and if you get any more than \$3,000 a month, it doesn't help you at all.

Chairman BUNNING. Thank you. Barb.

Mrs. KENNELLY. Nothing.

Chairman BUNNING. No questions? Thank you, Mr. Frank for your testimony.

The second panel, if they would take their place—well, we're going to mess up some names here. Cynthia Fagnoni.

Ms. FAGNONI. Fagnoni, right.

Chairman BUNNING. John Schaefer, Frank Mulvey, and Geoffrey Kollmann. Cynthia is the Director of Income Security Issues at the General Accounting Office, GAO; Mr. Schaefer, Senior Evaluator, Income Security Issues at GAO. Frank is the Assistant Director, Income Security Issues at the GAO, and Mr. Kollmann is the specialist in social legislation, education and public welfare division at the Congressional Research Service.

Cynthia, if you would begin, we'd appreciate it.

**STATEMENT OF CYNTHIA M. FAGNONI, DIRECTOR, INCOME SECURITY ISSUES, HEALTH, EDUCATION, AND HUMAN SERVICES DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY JOHN SCHAEFER, SENIOR EVALUATOR; AND FRANK MULVEY, ASSISTANT DIRECTOR**

Ms. FAGNONI. Thank you, Mr. Chairman. Good morning, Mr. Chairman and Members of the Subcommittee. I'm pleased to be here today—

Chairman BUNNING. Would you please pull it—that's it, so we can hear.

Ms. FAGNONI. I'm pleased to be here today to discuss the implications of extending mandatory Social Security coverage to all newly hired State and local government employees. Currently, the SSA, Social Security Administration, estimates that about 30 percent, or 5 million of the State and local work force is not covered by Social Security. As you are aware, Social Security Trust Funds will be exhausted by 2032 according to SSA estimates. To offset a part of this financial shortfall, the Social Security Advisory Council and others favor extending mandatory coverage to all newly hired State and local government workers.

Today, I will focus on three issues associated with mandatory coverage. These are: The implications of mandating such coverage for the Social Security Program; the impact of mandatory coverage on public employers, newly hired employees, and the affected pension plans; and the potential legal and administrative issues that are associated with implementing mandatory coverage.

My observations are based on work we are currently conducting for you, Mr. Chairman. Our work shows that in deciding whether to extend mandatory Social Security coverage to all newly hired State and local employees, that Congress will need to weigh several important factors associated with the three issues I'm going to discuss.



Regarding the first issue, implications for the Social Security Program, we found that mandatory coverage would benefit Social Security in several ways. Specifically, extending mandatory Social Security coverage to States and localities with noncovered workers would reduce the trust funds long-term financial shortfall; increase program participation, and simplify program administration. SSA estimates that mandatory coverage would reduce Social Security's financial shortfall by about 10 percent and extend the program's solvency by 2 years. As with most other individual elements aimed at improving long-term Social Security solvency such as raising the retirement age, extending coverage would resolve only a part of the trust fund solvency problem. This point has been well recognized in various reform packages such as those presented by the Social Security Advisory Council where a combination of adjustments were proposed in order to extend the program's solvency over a 75-year period.

Mandatory coverage would also increase participation in an important national program and simplify program administration. SSA estimates that about 95 percent of employees who are not covered by Social Security through their jobs with State and local governments become entitled to Social Security anyway either through other employment or as spouses or dependents. Individuals with dual coverage are subject to certain offsets as we've heard—the GPO and the WEP—that reduce their Social Security benefits. The Congress enacted these benefit reduction provisions to reduce the unfair advantage that workers who are eligible for pension benefits might have when they apply for Social Security benefits.

However, in a study we recently completed for you, Mr. Chairman, we found that SSA is often unable to determine whether applicants should be subject to the GPO or WEP. We estimate that failure to reduce benefits to Federal, State, and local employees has caused \$160 to \$355 million in overpayments between 1978 and 1995. Mandatory coverage would reduce such benefit adjustments by gradually reducing the number of employees in noncovered jobs.

With respect to the second mandatory coverage issue, we have determined that the impacts on employers, employees, and pension plans would vary depending on how States and localities respond to this new requirement. If all newly hired public employees were to receive Social Security coverage, they would have the income protections afforded by Social Security. At the same time, they and their employers would pay the combined Social Security payroll tax of 12.4 percent. Each State and locality with noncovered workers would need to decide how to deal with this increase in retirement costs and benefits. They could absorb the added cost and leave current pension plans unchanged or eliminate plans completely.

From discussions we've had with State and local representatives, we believe States and localities with noncovered workers would likely adjust their pension plans to reflect Social Security's costs and benefits. They could, for example, maintain similar benefits for current and newly hired employees or provide newly hired employees with benefits similar to those provided through the pension plans that are already coordinated with Social Security. Both of these responses would likely increase costs and benefits for newly hired employees.

On the other hand, States and localities could maintain level retirement spending. This may require a reduction in pension benefits. According to pension plan representatives, each of these responses to mandatory coverage would result in reduced contributions to current plans which could affect long-term financing of these plans.

The third area of impact we have addressed involved legal and administrative issues associated with mandatory coverage. Regarding legal issues, mandating Social Security coverage for State and local employees could elicit a constitutional challenge. Also, States and localities have told us that they may require up to 4 years to redesign pension formulas; legislate changes; adjust budgets, and disseminate information to employers and employees.

Mr. Chairman, this completes my statement this morning. I'd be pleased to answer any questions you or the Members may have.

[The prepared statement and attachment follow:]

**Statement of Cynthia M. Fagnoni, Director, Income Security Issues, Health, Education, and Human Services Division, U.S. General Accounting Office**

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to testify on extending mandatory Social Security coverage to all newly hired state and local government employees. Currently, the Social Security Administration (SSA) estimates that about 30 percent—or about 5 million employees—of the state and local workforce is not covered by Social Security. As you are aware, SSA projects Social Security revenues to fall short of expenditures starting in 2021 and the trust funds to be exhausted by 2032. To offset a part of the financial shortfall, the 1994–1996 Social Security Advisory Council favored extending mandatory coverage to all newly hired state and local government workers.

Today, I would like to focus on the implications of mandating such coverage for the Social Security program, public employers, newly hired employees, and the affected pension plans. I will also address potential legal and administrative issues associated with implementing mandatory coverage. My testimony is based on work we are currently conducting for the Chairman of this Subcommittee.

In summary, our work shows that mandating coverage for all newly hired public employees would reduce Social Security's long-term financial shortfall by about 10 percent, increase participation in an important national program, and simplify program administration. The impact on public employers, employees, and pension plans would depend on how states and localities with noncovered employees would react to these new coverage provisions. One often-discussed option would be for public employers to modify their pension plans in response to mandatory Social Security coverage. We will focus on this option. For example, many public pension plans currently offer a lower retirement age and higher retirement income benefit than Social Security. Social Security, on the other hand, offers complete inflation protection, full benefit portability, and dependent benefits, which are not available in many public pension plans. Costs would likely increase for those states and localities that wanted to keep their enhanced benefits for newly hired employees. Alternatively, states and localities that wanted to maintain level spending for retirement would likely need to reduce some pension benefits. Regardless, mandating coverage for public employees would present legal and administrative issues that would need to be resolved. For example, states and localities could require up to 4 years to design, legislate, and implement changes to current pension plans.

#### BACKGROUND

The 1935 Social Security Act mandated coverage for most workers in commerce and industry, which at that time comprised about 60 percent of the workforce. State and local government employees were excluded because they had their own retirement systems and there was concern over the question of the federal government's right to impose a tax on state governments.

Subsequently, the Congress extended mandatory Social Security coverage to most of the excluded groups, including state and local employees not covered by a public pension plan. The Congress also extended voluntary coverage to state and local employees covered by public pension plans. Since 1983, however, public employers have not been permitted to withdraw from the program once they are covered. SSA esti-

mates that 96 percent of the workforce, including 70 percent of the state and local government workforce, is now covered by Social Security.

Social Security provides retirement, disability, and survivor benefits to insured workers and their dependents. Insured workers are eligible for full retirement benefits at age 65<sup>1</sup> and reduced benefits at age 62. Social security retirement benefits are based on the worker's age and career earnings, are fully indexed for inflation after retirement, and replace a relatively higher proportion of the final year's wages for low earners. Social Security's primary source of revenue is the Old Age, Survivors, and Disability Insurance portion of the payroll tax paid by employers and employees. The payroll tax is 6.2 percent of earnings each for employers and employees, up to an established maximum.

SSA estimates that 5 million state and local government employees, excluding students and election workers, are not covered by Social Security. SSA also estimates that annual wages for noncovered employees total about \$132.5 billion. Seven states—California, Colorado, Illinois, Louisiana, Massachusetts, Ohio, and Texas—account for more than 75 percent of the noncovered payroll. A 1995 survey of public pension plans found that police, firefighters, and teachers are more likely to occupy noncovered positions than other employees.

Most full-time public employees participate in defined benefit pension plans. Minimum retirement ages for full benefits vary; however, many state and local employees can retire with full benefits at age 55 with 30 years of service. Retirement benefits also vary, but they are usually based on a specified benefit rate for each year of service and the member's final average salary over a specified time period, usually 3 years. For example, plans with a 2-percent rate replace 60 percent of a member's final average salary after 30 years of service. In addition to retirement benefits, a 1994 Department of Labor survey found that all members have a survivor annuity option, 91 percent have disability benefits, and 62 percent receive some cost-of-living increases after retirement.

As part of our study, we examined nine state and local defined benefit plans covering over 2 million employees. For those plans, employer contributions ranged from 6 to 14.5 percent of payroll and employee contributions ranged from 6.4 to 9.3 percent of payroll. (See the appendix.)

#### MANDATORY COVERAGE WOULD BENEFIT THE SOCIAL SECURITY PROGRAM

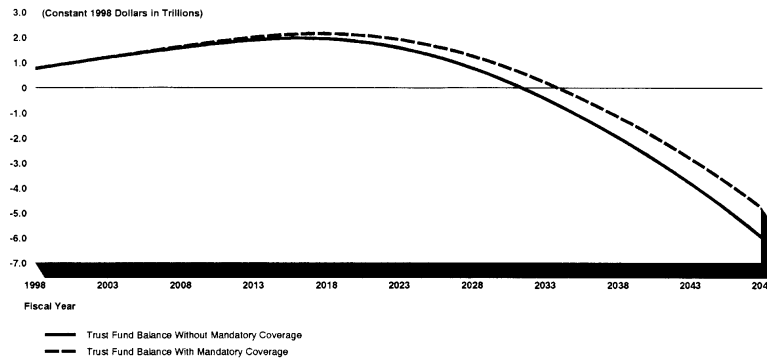
Extending mandatory Social Security coverage to states and localities with noncovered workers would reduce the trust funds' long-term financial shortfall, increase program participation, and simplify program administration.

SSA estimates that mandatory coverage would reduce Social Security's financial shortfall by about 10 percent—from 2.19 percent of payroll (a present discounted value of \$3.1 trillion) to 1.97 percent of payroll (a present discounted value of \$2.9 trillion)—over a 75-year period.<sup>2</sup> Figure 1 shows that mandatory coverage would also extend the program's solvency by about 2 years, from 2032 to 2034. As with most other elements of the reform proposals put forward by the 1994–1996 Social Security Advisory Council, such as raising the retirement age, extending mandatory coverage to newly hired state and local employees would resolve only a part of the trust funds' solvency problem. A combination of adjustments will be needed to extend the program's solvency over the entire 75-year period.

<sup>1</sup> Beginning with those born in 1938, the age at which full benefits are payable will increase in gradual steps from age 65 to age 67.

<sup>2</sup> SSA uses a period of 75 years for evaluating the program's long-term actuarial status to obtain the full range of financial commitments that will be incurred on behalf of current program participants.

Figure 1: Comparison of Projected End-of-Year Trust Fund Balances With and Without Mandatory Coverage, 1998 to 2048



Note: SSA data were based on intermediate assumptions in the 1998 Board of Trustees report. SSA assumed that mandatory coverage would be effective beginning January 1, 2000.

Source: GAO analysis of SSA data.

SSA data indicate that revenues from payroll taxes on the newly covered workers, taxes on their benefits, and interest on the added trust fund balances would substantially exceed additional expenditures throughout the 75-year period. SSA assumes that payroll tax collections for new employees would accelerate early in the 75-year period, while benefits for those employees would not rise significantly until later in the period.

While Social Security's solvency problems have triggered an analysis of the impact of mandatory coverage on program revenues and expenditures, the inclusion of such coverage in a comprehensive reform package would need to be grounded in other considerations. In recommending that mandatory coverage be included in the reform proposals, the Advisory Council stated that mandatory coverage is basically "an issue of fairness." The Advisory Council report stated that "an effective Social Security program helps to reduce public costs for relief and assistance, which, in turn, means lower general taxes. There is an element of unfairness in a situation where practically all contribute to Social Security, while a few benefit both directly and indirectly but are excused from contributing to the program."

Mandatory coverage would also simplify program administration in the long run. SSA's Office of Research, Evaluation, and Statistics estimates that 95 percent of noncovered state and local employees become entitled to Social Security as either workers, spouses, or dependents. SSA's Office of the Chief Actuary estimates that 50 to 60 percent of noncovered employees will be fully insured by age 62 from covered employment.

The Congress has established the government pension offset and windfall elimination provisions to reduce the unfair advantage that workers who are eligible for pension benefits based on noncovered employment might have when they apply for Social Security benefits. The earnings histories for workers with noncovered earnings may appear to qualify them for the higher earnings replacement rates that Social Security assigns to lower earners, when in fact they have substantial income from public pension plans. With some exceptions, the government pension offset and windfall elimination provisions require SSA to use revised formulas to calculate benefits for workers with noncovered employment.

However, a separate GAO study for the Chairman of this Subcommittee indicates that SSA is often unable to determine whether applicants should be subject to the government pension offset or windfall elimination provisions.<sup>3</sup> We estimate that failure to reduce benefits for federal, state, and local employees caused \$160 million to \$355 million in overpayments between 1978 and 1995. In response, SSA plans to perform additional computer matches with the Office of Personnel Management and the Internal Revenue Service (IRS) to get noncovered pension data in order to ensure that these provisions are applied. Mandatory coverage would reduce benefit adjustments by gradually reducing the number of employees in noncovered jobs. Eventually, all state and local employees, with the exception of a few categories of workers, such as students and election workers, would be in covered employment.

Additionally, in 1995, SSA asked its Inspector General to undertake a review of state and local government employers' compliance with Social Security coverage provisions. In December 1996, SSA's Office of the Inspector General reported that Social Security provisions related to coverage of state and local employees are complex and difficult to administer.<sup>4</sup> The report stated that few resources were devoted to training state and local officials and ensuring that administration and enforcement roles and responsibilities are clearly defined. The report concluded that there is a significant risk of sizeable noncompliance with state and local coverage provisions. In response, SSA and IRS, which is responsible for collecting Social Security payroll taxes, initiated an effort to educate employers and ensure compliance with legal requirements for withholding Social Security payroll taxes.

#### IMPACT OF MANDATORY COVERAGE ON EMPLOYERS, EMPLOYEES, AND THEIR PENSION PLANS WOULD VARY

If all newly hired public employees were to receive mandated Social Security coverage, they would have the income protection afforded by Social Security. Also, they and their employers would pay the combined Social Security payroll tax of 12.4 percent of payroll. Each state and locality with noncovered workers would decide how to respond to the increase in retirement costs and benefits. They could absorb the added cost and leave current pension plans unchanged or eliminate plans completely. From discussions with state and local representatives, however, we believe states and localities with noncovered workers would likely adjust their pension plans to reflect Social Security's costs and benefits. To illustrate the implications of mandatory coverage to employers and employees, we examined three possible responses:

- States and localities could maintain similar benefits for current and newly hired employees. This response would likely result in an increase in total retirement costs and some additional benefits for many newly hired employees.

- States and localities could examine other pension plans that are already coordinated with Social Security and provide newly hired employees with similar benefits. This response would also likely increase costs and benefits for newly hired employees.

- States and localities could maintain level retirement spending. This response could require a reduction in pension benefits.

According to pension plan representatives, each of these responses to mandatory coverage would result in reduced contributions to current plans, which could affect long-term financing of the plans.

#### *Maintaining Level Benefits Would Likely Increase Costs*

States and localities with noncovered workers could opt to provide newly hired employees with Social Security and pension benefits that, in total, approximate the pension benefits of current employees. Studies indicate that such an option could increase retirement costs by 7 percent of new-employee payroll. Using SSA's data and its assumption that mandatory coverage would start January 1, 2000, a 7 percent of payroll increase in retirement costs for newly hired employees would mean additional costs to states and localities with noncovered workers of about \$9.1 billion over the first 5 years.

A 1980 study of the costs of providing Social Security coverage for noncovered workers provides support for the estimated 7 percent of payroll increase. The Universal Social Security Coverage Study Group developed options for mandatory coverage of employees at all levels of government and analyzed the fiscal effects of each

<sup>3</sup> *Social Security: Better Payment Controls for Benefit Reduction Provisions Could Save Millions* (GAO/HEHS-98-76, Apr. 30, 1998).

<sup>4</sup> *Social Security Coverage of State and Local Government Employees*, SSA Office of the Inspector General (A-04-95-0613, Dec. 13, 1996).

option. The study group used two teams of actuaries to study over 40 pension plans. The study estimated that costs, including Social Security taxes and pension plan contributions, would need to increase an average of 2 to 7 percent of payroll to maintain level benefits for current and newly hired employees.<sup>5</sup>

The study assumed that most newly hired employees would have salary replacement percentages in their first year of retirement that would be comparable to those provided to current employees. For example, employees retiring before age 62 would receive a temporary supplemental pension benefit to more closely maintain the benefits of the current plan. Since Social Security benefits are fully indexed for inflation and many pension plans have limited or no cost-of-living protection, total lifetime benefits for many newly hired employees would be greater than those provided to current employees. Existing pension plan disability and survivor benefits were also adjusted to reflect Social Security disability and survivor benefits.

More recent studies by pension plan actuaries in Colorado, Illinois, and Ohio also indicate the cost increase would be in that same range. For example, a December 1997 study for a plan in Ohio indicated that providing retirement and other benefits for future employees that, when added to Social Security benefits, approximate benefits for current employees would require an increase in contributions of 6 to 7 percent of new-employee payroll. A 1997 study for a pension plan in Illinois indicated the increased payments necessary to maintain similar total benefits for current and future employees would be about 6.5 percent of new-employee payroll.

The 1980 study stated that the causes of the cost increase cannot be ascribed directly to specific Social Security or pension plan provisions. The study also states, however, that certain Social Security and pension plan provisions are among the most important factors contributing to the cost increase. Social Security is fully indexed for cost-of-living increases, is completely portable, and provides substantial additional benefits for spouses and dependents. In addition, pension plans would need to provide special supplemental benefits for employees who retire before age 62, especially in police and firefighter plans.

The study also found that the magnitude of the cost increase would depend on the pension plan's current benefits. Cost increases would be less for plans that already provide disability, survivor, and other benefits similar to those provided by Social Security because those plans would be able to eliminate duplicate benefits.

#### *Matching Pension Benefits of Currently Covered Employees Would Likely Increase Costs*

About 70 percent of the state and local workforce is already covered by Social Security. If coverage is mandated, states and localities with noncovered employees could decide to provide newly hired employees with pension plan benefits similar to those provided to currently covered employees.

The 1980 study examined this option and concluded that implementation would increase costs by 6 to 14 percent of payroll—or 3 to 11 percent of payroll after eliminating the Medicare tax. The study also found that most pension plans for covered employees did not provide supplemental retirement benefits for employees who retire before Social Security benefits are available. For most of the examined pension plans, the present value of lifetime benefits for employees covered by Social Security would be greater than the value of benefits for current noncovered employees.

Our analysis of 1995 Public Pension Coordinating Council data also indicates that retirement costs for states and localities covered by Social Security are higher than the costs for noncovered states and localities. For the pension plans that responded to the survey, the average employee cost rate was about 9 percent of pay in covered plans, including Social Security taxes, and 8 percent of pay in noncovered plans. The average employer cost rate, excluding the cost of unfunded liabilities, was about 12 percent of payroll for employers in covered plans, including Social Security taxes, and 8 percent of payroll for employers in noncovered plans.

These data also indicate that many employees in covered and noncovered plans, especially police and firefighters, retire before age 65, when covered employees would be eligible for full Social Security benefits. Our analysis indicates that covered employees who retire before age 65 initially have a lower salary replacement rate than noncovered employees. The average salary replacement rate with 30 years of service was 53 percent for members of Social Security covered plans and 64.7 percent for members of noncovered plans.

At age 65, however, Social Security covered employees have a higher total benefit than noncovered employees. According to the Department of Labor's 1994 survey,

<sup>5</sup>The study estimate was 5 to 10 percent of payroll. We deducted the 2.9 percent of payroll Medicare tax since it was mandated for all newly hired state and local employees in 1986, after the study was completed.

for example, an employee age 65 with 30 years of service, final earnings of \$35,000, and Social Security coverage had 87 percent of earnings replaced—51 percent by a pension plan and 36 percent by Social Security. The same employee with no Social Security coverage had 63 percent of earnings replaced by a pension plan. We did not compare the expected value of total lifetime benefits for covered and noncovered employees because amounts would vary depending on the benefits offered by each plan.

Additionally, the extent to which the experience of states and localities with covered employees can be generalized to those with noncovered employees is limited. According to the 1980 study, most public pension plans that coordinated with Social Security did so in the 1950s and 1960s when Social Security benefits and payroll taxes were much smaller. As Social Security benefits grew, pension plan benefits remained basically unchanged. Starting in the 1970s, however, rising pension costs caused several large state systems to consider reducing their relatively liberal pension benefits. In the 1980s, for example, California created an alternative set of reduced benefits for general employees to, among other things, reduce the state's retirement costs. Initially, general employees were permitted to select between the higher costs and benefits of the original plan and the lower costs and benefits of the revised plan. Subsequently, however, newly hired general employees were limited to the reduced benefits.

#### *Level Retirement Spending Could Mean Reduced Benefits*

Several employee, employer, and plan representatives stated that spending increases necessary to maintain level retirement income and other benefits for current and future members would be difficult to achieve. They indicate that states and localities might decide to maintain current spending levels, which could result in reduced benefits under state and local pension plans for many employees.

A June 1997 actuarial evaluation of an Ohio pension plan examined the impact on benefits of mandating Social Security coverage for all employees, assuming no increase in total retirement costs. The study concluded that level spending could be maintained if (1) salary replacement rates for employees retiring with 30 years of service were reduced from 60.3 percent to 44.1 percent, (2) current retiree health benefits were eliminated for both current and future employees, and (3) the funding period for the plan's unfunded accrued liability were extended from 27 years to 40 years.

#### *Impact on Pension Plan Finances Is Uncertain*

Most states and localities use a reserve funding approach to finance their pension plans. In reserve funding, employers—and frequently employees—make systematic contributions toward funding the benefits earned by active employees. These contributions, together with investment income, are intended to accumulate sufficient assets to cover promised benefits by the time employees retire.

However, many public pension plans have unfunded liabilities. The nine plans that we examined, for example, have unfunded accrued liabilities ranging from less than 1 percent to over 30 percent of total liabilities. Unfunded liabilities occur for a number of reasons. For example, public plans generally use actuarial methods and assumptions to calculate required contribution rates. Unfunded liabilities can occur if a plan's actuarial assumptions do not accurately predict reality. Additionally, retroactive increases in plan benefits can create unfunded liabilities. Unlike private pension plans, the unfunded liabilities of public pension plans are not regulated by the federal government. States or localities determine how and when unfunded liabilities will be financed.

Mandatory coverage and the resulting changes to plan benefits for newly hired employees are likely to result in reduced contributions to the current pension plan. The impact of reduced contributions on plan finances would depend on the actuarial method and assumptions used by each plan, the adequacy of current plan funding, and other factors. For example, plan representatives are concerned that efforts to provide adequate retirement income benefits for newly hired employees would affect employers' willingness or ability to continue amortizing their current plans' unfunded accrued liabilities.

#### LEGAL AND OTHER CONSIDERATIONS

Mandatory coverage presents several legal and administrative issues, and states and localities could require several years to design, legislate, and implement changes to current pension plans.

### *Legal Considerations*

Mandating Social Security coverage for state and local employees could elicit a constitutional challenge. We believe that mandatory coverage is likely to be upheld under current Supreme Court decisions.

Several employer, employee, and plan representatives with whom we spoke stated that they believe mandatory Social Security coverage would be unconstitutional and should be challenged in court. However, recent Supreme Court cases have affirmed the authority of the federal government to enact taxes that affect the states and to impose federal requirements governing the states' relations with their employees.

A plan representative suggested that the Court might now come to a different conclusion. He pointed out that a case upholding federal authority to apply minimum wage and overtime requirements to the states was a 5 to 4 decision and that until then, the Court had clearly said that applying such requirements to the states was unconstitutional. States and localities also point to several recent decisions of the Court that they see as sympathetic to the concept of state sovereignty. However, the facts of these cases are generally distinguishable from the situation that would be presented by mandatory Social Security coverage.

Unless the Court were to reverse itself, which it seldom does, mandatory Social Security coverage of state and local employees is likely to be upheld. Current decisions indicate that mandating such coverage is within the authority of the federal government.

### *States Would Require Up to 4 Years to Implement Mandatory Coverage*

The federal government required approximately 3 years to enact legislation to implement a new federal employee pension plan after Social Security coverage was mandated for federal employees in 1983. According to the 1980 Universal Social Security Coverage Study Group, transition problems for state and local employers would be different from those faced by the federal government. For example, benefit provisions vary among the thousands of public employee retirement plans, as do the characteristics of the employees covered by those plans. Additionally, state governments and many local governments have laws regulating pensions. The study group estimated that 4 years would be required to redesign pension formulas, legislate changes, adjust budgets, and disseminate information to employers and employees. Our discussions with employer, employee, and pension plan representatives also indicate that up to 4 years would be needed to implement a mandatory coverage decision.

Additionally, constitutional provisions or statutes in some states may prevent employers from reducing benefits for employees once they are hired. These states may need to immediately enact legislation to draw a line between current and future employees until decisions are made concerning the pension benefits for new employees who would be covered by Social Security. According to the National Conference of State Legislators, legislators in seven states, including Texas and Nevada, meet only biennially. Therefore, the initial legislation could require 2 years in those states.

### CONCLUDING OBSERVATIONS

In deciding whether to extend mandatory Social Security coverage to all newly hired state and local employees, the Congress will need to weigh several factors. First, the Social Security program would benefit from mandatory coverage. The long-term actuarial deficit would be reduced, and the trust funds' solvency would be extended for about 2 years. However, there are other considerations besides this relatively small contribution to the program's solvency. Mandatory coverage would also increase participation in an important national program and simplify program administration.

The implications for state and local employers, employees, and pension plans would be determined in part by employers' responses to Social Security coverage. States and localities with noncovered workers would likely need to increase total retirement spending to provide future workers with pension benefits that, when combined with Social Security benefits, approximate the benefits provided to current workers. At the same time, Social Security would provide newly hired employees with benefits that are not available, or are available to a lesser extent, under current state and local pension plans.

In addition, mandatory coverage would present legal and administrative issues. States and localities might attempt to halt mandatory Social Security coverage in court, although such a challenge is unlikely to be upheld. Finally, states and localities could require up to 4 years to implement mandatory coverage.

Mr. Chairman, this concludes my prepared statement. At this time, I will be happy to answer any questions you or the other Subcommittee Members may have.



## Appendix

### Noncovered Employees and their Pension Plans

SSA estimates that about 4 million of the approximately 5 million state and local employees not covered by Social Security are in the seven states with the largest number of noncovered workers. (See table I.1.)

Table I.1: States With the Largest Number of Noncovered Workers

State	Number of non-covered employees (in thousands)
California .....	1,200
Colorado .....	200
Illinois .....	400
Louisiana .....	300
Massachusetts .....	400
Ohio .....	800
Texas .....	700
<b>Total .....</b>	<b>4,000</b>

Source: Office of the Chief Actuary, SSA.

The nine public pension plans included in our study have about 2 million members. For the most part, members of these plans are not covered by Social Security. (See table I.2.)

Table I.2: Membership, Contribution Rates, and Assets for Nine Public Pension Plans

Public pension plan	Active members	Benefit recipients	Contribution rate <sup>1</sup>			Net assets (in billions)
			Employer	Employee	Total	
California State Teachers' Retirement System .....	364,000	154,000	12.5%	8.0%	20.5%	\$74.8
Public Employees' .....	148,000	46,000	11.6	8.01	9.61	9.9
Teachers' Retirement System of Illinois .....	137,000	59,000	7.9	8.0	15.9	17.4
Louisiana State Employees' Retirement System .....	70,000	27,000	12.0	7.5	19.5	4.3
Massachusetts State Employees' Retirement System .....	83,000	42,000	14.5	9.0	23.5	9.6
Massachusetts State Teachers' Retirement System .....	69,000	29,000	14.0	9.0	23.0	9.9
State Teachers Retirement System of Ohio .....	169,000	89,000	14.0	9.3	23.3	42.4
Public Employees Retirement System of Ohio .....	345,000	146,000	13.3	8.5	21.8	39.8
Teacher Retirement System of Texas .....	695,000	158,000	6.0	6.4	12.4	62.2
<b>Total .....</b>	<b>2,080,000</b>	<b>750,000</b>	.....	.....	.....	<b>\$280.3</b>

<sup>1</sup> Employer rate includes contributions toward the plan's unfunded liability. Employee rate is the rate for general employees.

Source: State and pension plan financial reports.

Chairman BUNNING. Thank you very much.  
Mr. Kollmann.

**STATEMENT OF GEOFFREY KOLLMANN, SPECIALIST, SOCIAL  
LEGISLATION, EDUCATION AND PUBLIC WELFARE DIVISION,  
CONGRESSIONAL RESEARCH SERVICE**

Mr. KOLLMANN. Thank you, Mr. Chairman. Mr. Chairman and Members of the Subcommittee, I was asked to summarize and briefly discuss issues concerning two provisions of current law that can reduce or eliminate Social Security benefits payable to government employees. The two provisions are the government pension offset provision and windfall elimination provision. They affect the Social Security benefits of persons who also receive a pension from employment not covered by Social Security—for example, the civil service retirement system for Federal workers and State and local government employees whose States have not chosen Social Security coverage and who are participating in retirement plans. The purpose of both provisions is to prevent what otherwise would be considered to be an unfair advantage for government compared to private sector workers.

The first provision, the windfall elimination, reduces the Social Security benefit, earned as a worker, of the affected individuals by applying a different formula to the computation of their benefits. Ordinarily, the Social Security benefit formula applies three progressive factors—90, 32, and 15 percent—to three different levels or brackets of average monthly covered earnings. However, for a worker subject to the windfall elimination rules, the 90-percent factor in the first band of a benefit formula is replaced by a factor of 40 percent. The effect is to reduce their benefits by lowering the amount of the earnings in the first bracket that is converted to benefits.

The provision includes a guarantee, which is designed to protect workers with low pensions, that the reduction in benefits caused by the windfall formula cannot exceed one-half of the noncovered pension. The provision exempts workers who have 30 or more years of substantial employment covered under Social Security, and lesser reductions apply to workers with 21 through 29 years of substantial covered employment.

Enacted in 1983, the purpose of this provision was to remove an unintended advantage that the regular Social Security benefit formula provided to persons who also had pensions from non-Social Security covered employment. The regular formula was intended to help workers, who spent their work careers in low-paying jobs, by providing them with a benefit that replaces a higher proportion of their earnings than the benefit that's provided for workers with high earnings. However, the formula could not differentiate between those who worked in low-paying jobs throughout their careers and other workers who appeared to have been low paid because they worked many years in jobs not covered by Social Security. Those years show up as zeros in the Social Security earnings records.

Thus, under the old law, workers who were employed for only a portion of their careers in jobs covered by Social Security, even highly paid ones, also received the advantage of this weighted for-

mula, because their few years of covered earnings were averaged over their entire working career to determine the average covered earnings on which their Social Security benefits were based. The windfall elimination is intended to remove this advantage for these workers.

Proponents of the provision say that it is a reasonable means to prevent payment of overgenerous and unintended benefits to certain workers who otherwise would profit from happenstance, that is, the mechanics of the Social Security benefit formula. Opponents of the provision believe it is unfair, because it substantially reduces a benefit that workers had included in their retirement plans. Others criticize how the provision works. They say the 40-percent factor is arbitrary and is an inaccurate way to determine the actual windfall when applied to individual cases. For example, they say it overpenalizes low-paid workers with short careers or with full careers that are fairly evenly split. They also say it is regressive, because the reduction is confined to the first bracket of the benefit formula and causes a relatively larger reduction in benefits for low-paid workers.

The second provision, the government pension offset, reduces Social Security benefits' spousal benefits that is, benefits payable as a dependent of Social Security—covered workers to persons who receive a pension from government employment that was not covered by Social Security. It is intended to place spouses whose government employment was not covered by Social Security in approximately the same position as other workers by applying the equivalent of Social Security's "dual entitlement" rule, which subtracts 100 percent of Social Security worker benefit from any Social Security spousal benefit. To do this, it is assumed that two-thirds of the government pension is approximately equivalent to a Social Security benefit the spouse would receive as a worker if his or her job had been covered by Social Security. Thus, the provision attempts to replicate the Social Security dual entitlement rule by requiring that two-thirds of the government pension be subtracted from the Social Security spousal benefit.

As with the windfall elimination provision, critics say that the GPO is not well understood and that many affected by it are unprepared for smaller Social Security benefits than they had assumed in making retirement plans. They also argue that whatever its rationale, reducing everyone's spousal benefit by two-thirds of the their government pension is an imprecise way to estimate what the spousal would be, had the government job been covered by Social Security. They say that this procedure has uneven results and it may be especially disadvantageous for surviving spouses with low income, particularly women.

Defenders of the government pension offset maintain it is an effective method to curtail what otherwise would be an unfair advantage for government workers. They also point out that Social Security's dual entitlement rule, which the government pension offset is designed to replicate, also can reduce the income of already low-income recipients, and that if this issue is to be addressed, using other means or programs that more accurately measure need and apply to the general population would be more appropriate than changing just the government pension offset provision.

Mr. Chairman, this concludes my testimony.  
[The prepared statement follows:]

**Statement of Geoffrey Kollmann, Specialist, Social Legislation, Education  
and Public Welfare Division, Congressional Research Service**

Mr. Chairman and Members of the Committee, I was asked to summarize and briefly discuss issues concerning two provisions of current law that can reduce or eliminate Social Security benefits payable to government employees. The two provisions are the government pension offset provision and the windfall elimination provision. They affect the Social Security benefits of persons who also receive a pension from non-Social Security-covered employment, e.g., the federal Civil Service Retirement System (CSRS) and state and local government employees whose states have not chosen Social Security coverage and who are participating in a retirement plan. They do not affect government workers whose pensions are based on Social Security-covered employment, e.g., those with full careers under the Federal Employees Retirement System (FERS). The purpose of both provisions is to prevent what otherwise would be an unfair advantage for government compared to private sector workers.

THE WINDFALL ELIMINATION PROVISION

Enacted in 1983, this provision reduces the Social Security benefit, earned as a worker, of the affected individuals by applying a different formula to the computation of their benefits. Ordinarily, the Social Security benefit formula applies three progressive factors—90%, 32%, and 15%—to three different levels, or brackets, of average monthly covered earnings. However, for workers subject to the Windfall Elimination rules, the 90% factor in the first band of the benefit formula is replaced by a factor of 40%. The effect is to reduce their benefits by lowering the amount of their earnings in the first bracket that is converted to benefits. Following is an example of how the provision works in 1998:

MONTHLY BENEFIT FOR WORKER WITH AVERAGE MONTHLY EARNINGS OF \$1,000

*Regular formula*

90% of first \$477	\$429.30	
32% of \$477 through \$2,875		167.30
15% over \$2,875	00.00	
Total	583.90	

*"Windfall formula"*

40% of first \$477	\$190.80	
32% of \$477 through \$2,875		167.30
15% over \$2,875	00.00	
Total	358.10	

The provision includes a guarantee (designed to help protect workers with low pensions) that the reduction in benefits caused by the windfall formula can not exceed one-half of the pension that is based on non Social Security-covered work. The provision also exempts workers who have 30 or more years of "substantial" employment covered under Social Security (i.e., having earned at least one-quarter of the Social Security maximum taxable wage base for each year in question). Also, lesser reductions apply to workers with 21 through 29 years of substantial covered employment.

The purpose of this provision was to remove an unintended advantage that the regular Social Security benefit formula provided to persons who also had pensions from non-Social Security-covered employment. The regular formula was intended to help workers who spent their work careers in low paying jobs, by providing them with a benefit that replaces a higher proportion of their earnings than the benefit that is provided for workers with high earnings. However, the formula could not differentiate between those who worked in low-paid jobs throughout their careers and other workers who appeared to have been low paid because they worked many years in jobs not covered by Social Security (as earnings in these years do not show up on Social Security's records, they are shown as zeros for Social Security benefit purposes). Thus, under the old law, workers who were employed for only a portion of their careers in jobs covered by Social Security—even highly paid ones—also received the advantage of the "weighted" formula, because their few years of covered earnings were averaged over their entire working career to determine the average covered earnings on which their Social Security benefits were based. The Windfall

Elimination Provision formula is intended to remove this advantage for these workers.

Proponents of the provision say that it is a reasonable means to prevent payment of overgenerous and unintended benefits to certain workers who otherwise would profit from happenstance, i.e., the mechanics of the Social Security benefit formula. They maintain that the provision rarely causes hardship because by and large the people affected are reasonably well off, as most of them also receive government pensions.

Opponents of the provision believe it is unfair because it substantially reduces a benefit that workers had included in their retirement plans. Others criticize how the provision works. They say the arbitrary 40% factor in the formula is an inaccurate way to determine the actual windfall when applied to individual cases. For example, they say it over-penalizes lower paid workers with short careers, or with full careers that are fairly evenly split. They also say it is regressive, because the reduction is confined to the first bracket of the benefit formula and causes a relatively larger reduction in benefits for low-paid workers.

#### THE GOVERNMENT PENSION OFFSET PROVISION

Enacted in 1977, this provision reduces Social Security spousal benefits, i.e., benefits payable as a dependent of a Social Security-covered worker, to persons who receive a pension from government employment that was not covered by Social Security. The GPO is intended to place retirees whose government employment was not covered by Social Security and who are eligible for a Social Security spousal benefit in approximately the same position as other retirees whose jobs were covered by Social Security. Social Security retirees are subject to an offset of spousal benefits according to that program's "dual entitlement" rule. That rule requires that a Social Security retirement benefit earned by a worker be subtracted from his or her Social Security spousal benefit, and the resulting difference, if any, is the amount of the spousal benefit paid. Thus, workers retired under Social Security may not collect their own Social Security retirement benefit as well as a full spousal benefit. The rationale is that a Social Security spousal benefit is based on the concept of "dependency," and someone who receives his or her own Social Security benefit as a retired worker is not completely financially dependent on his or her spouse.

The GPO replicates the Social Security dual entitlement rule by assuming that two-thirds of the government pension is approximately equivalent to a Social Security retirement benefit the worker would receive if his or her job had been covered by Social Security. Thus, the GPO requires that two-thirds of the government pension be subtracted from the Social Security spousal benefit, and only the resulting difference, if any, is paid. (Implicit in this arrangement is the assumption that the remaining one-third is equivalent to a private pension.). Following is an example of the way the GPO works. Before the GPO is applied, a couple's situation could be like this:

##### *Government Worker's Benefits*

\$600 = government pension  
\$450 = potential spousal benefit ( $\frac{1}{2} \times \$900$ )

##### *Worker's Spouse's Benefits*

\$900 = Social Security worker benefit

After application of the GPO, the couple's situation would be this:

##### *Government Worker's Benefits*

\$600 = government pension  
\$50 = spousal benefit ( $\frac{2}{3} \times \$600 = \$400$ , which subtracted from \$450 = \$50)

##### *Worker's Spouse's Benefits*

\$900 = Social Security worker benefit

Critics of the GPO say that it is not well understood and that many affected by it are unprepared for a smaller Social Security benefit than they had assumed in making retirement plans. They also argue that, whatever its rationale, reducing everyone's spousal benefit by two-thirds of their government pension is an imprecise way to estimate what the spousal benefit would be had the government job been covered by Social Security. They say that this procedure has uneven results and that it may be especially disadvantageous for surviving spouses with low incomes.

Defenders of the GPO maintain that it is an effective method to curtail what otherwise would be an unfair advantage for government workers. The provision was phased in over six years and now has been in the law for 21 years; therefore, they

say, there has been ample time for people to adjust their retirement plans. They also point out that Social Security's dual entitlement rule, which the GPO is designed to replicate, also can reduce the income of already low-income recipients, and that if this issue is to be addressed, using other means or programs that more accurately measure need, and apply to the general population, would be more appropriate than changing just the GPO.

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Chairman BUNNING. Thank you both for your testimony. Let me ask you both one simple question. In the overall restructuring—or whatever we come up with as far as Social Security reform is concerned—to make sure that the trust fund remains solvent past the year 2032—or whenever the deadline is where we can only pay 75 percent of our benefits out—do you both think that this needs to be addressed in the overall restructuring of the Social Security system? In other words, both the pension offset and the offset for windfall.

Mr. KOLLMANN. Well, I would point out that the two antiwindfall measures, as time goes by, and you get out toward that 2032 figure, in many instances they won't be applicable anymore. For example, Federal workers have been covered mandatorily by Social Security if they were hired after 1983.

Chairman BUNNING. I am speaking only of those who are uncovered or are subject to the offsets.

Mr. KOLLMANN. Yes, and what I'm saying is that Social Security's financial problems, of course, are not in the short range since we have substantial surpluses over the next decade or so, and the projected date of insolvency being three decades from now, with the passage of time the effect of changing these provisions won't have much of an effect in the out years when Social Security really starts to face financial problems. Now, if you—

Chairman BUNNING. But it will have—if we do it 3 years from now, it will have a direct effect on the short term particularly for those who are getting a major offset in their benefit presently.

Mr. KOLLMANN. That's correct.

Ms. FAGNONI. On the mandatory coverage issue, as we've noted in our testimony and as you've pointed out, the proposals to reform Social Security when they include this mandatory coverage, are always just one piece of a whole package of reforms, because mandatory coverage alone will not solve the problem. If mandatory coverage were enacted, though, as we mention in our testimony, that would accelerate the phase out of the WEP and GPO because then new State and Federal employees would be covered under Social Security, and, therefore, no longer needs to be subject to the WEP/GPO.

Chairman BUNNING. Do you both believe that we should address—the offset seemed fair at the time of enactment. Do you think it is fair now? In other words, we have an awful lot of people that really get whacked on their Social Security benefits because of their pension being done by State and local government, not so much in the Federal Government, but do you think it's fair and we should change it?

Ms. FAGNONI. We haven't examined that issue directly. It's understandable why the WEP and GPO were enacted because—

Chairman BUNNING. Well, I know the reasons at that time.

Ms. FAGNONI. Right, but they would look like a low-income earner when they might not in fact be. One thing I would point out: The study we did for you that we issued recently—you asked us to look at how effectively WEP and GPO are being administered by SSA—and what our report really shows is how difficult those provisions are to administer.

Chairman BUNNING. Well, if we're blowing \$350 million out the door for mistakes in overpayment, yes, it's important.

Ms. FAGNONI. So, they're complicated provisions to administer. It's difficult for SSA to, check up to see that they're applying the WEP and GPO correctly. So, in that sense, that would be one advantage to at least mandating where these sort of interactions—

Chairman BUNNING. If we mandated coverage, how quickly would we be able to implement doing away with the offsets? In other words, it's going to take some transition time to do it.

Ms. FAGNONI. Yes, because the coverage would just apply to new workers and the estimate would be that it could take up to a whole generation of workers of 30 years for it to completely phase out, but it would depend on what the makeup of the new work force looked like, how quickly that really would happen.

Chairman BUNNING. Well, obviously, if somebody has been working in local, State, and municipal governments for 40 years and they're 62, their transition is going to be very difficult, but somebody who's just starting in employment in local, State, or municipal governments, you would have a transition period of 20, 25 years if they stayed with it.

I appreciate your testimony.

Mrs. Kennelly.

Mrs. KENNELLY. Thank you both. You indicate that the cost to States would increase if States were to try to provide benefits to current workers which are equal to the benefits which would be provided to newly hired workers covered under Social Security, and I just have a couple of questions to play off that statement. First of all, as the Chairman and I have been involved with disability improvements and trying to reform and improve disability benefits, how would you compare the disability—and I'll add survivor and spousal benefits—available to State and local workers to the benefits available under Social Security?

Ms. FAGNONI. Overall, one of the biggest differences seems to be that most State and local plans provide for disability and survivors benefits. Many of them do not provide a spousal benefit, so there's one difference right there. One of the biggest differences has to do with how the disability benefits are applied; when somebody becomes eligible. Generally, under State and local plans, they're tied to years of service and earnings, so that, for example, one plan, one of the nine plans we looked at, an individual would not be entitled to disability benefits until he had worked there for 5 years. Now, under Social Security, that's generally true that one would have to have worked for 5 years, 20 quarters, to be eligible for DI, Disability Insurance, but there are special provisions for workers who are under the age of 31 who become disabled early in their work years, and that kind of adjustment is not generally available under the State and local plans. Studies have indicated that younger, low-

earning workers might not fair as well under the State and local plans as they might under Social Security, both for the disability as well as the survivor's benefits.

Mrs. KENNELLY. Thank you. Another area we've been looking at and continue to look at is benefits for people age 62 to 65. Would you do the same comparison of replacement rates for 62-to-65-year-old retirees under Social Security and under State and local plans?

Ms. FAGNONI. In terms of replacement rates——

Mrs. KENNELLY. If you don't have that right——

Ms. FAGNONI. Yes, I'm not sure we have that in terms of the difference. We do know that a number of the State and local plans provide for earlier retirement than Social Security does, and many of the plans that have elected to be covered under Social Security in the past have continued to provide for that supplemental early retirement benefit to keep people in some kind of retirement income before Social Security retirement eligibility kicks in.

Mrs. KENNELLY. Thank you.

Thank you, Mr. Chairman.

Chairman BUNNING. The gentleman from California.

Mr. BECERRA. Thank you, Mr. Chairman. Can you give me a sense as to whether you've been able to calculate the amount that Social Security provides to those who are disabled or become disabled, or for the surviving spouse of a Social Security recipient; what that benefit amounts to, and how that compares to what a State or local government pension plan might provide?

Ms. FAGNONI. We did not look at that provision specifically from a disability comparison. We did look more generally at how the disability provisions vary, and one other aspect of disability in State and local plans is that the provisions vary widely among the plans, and the definition of disability can vary considerably. Generally, a major distinction in the disability definition between Social Security and State and local plans is that under Social Security one must be disabled and unable to have any substantial gainful activity in any kind of job, whereas the State and local disability provisions generally target the disability in terms of whether or not that individual can continue to work at that specific job. Beyond that, how disability is defined can vary widely among the different plans. So, it's pretty difficult to compare other than to say the provisions vary considerably.

Mr. KOLLMANN. I would add that Social Security benefits vary by the person's earning history, but if you take someone who always earned an average wage, the disability benefits are computed as if they were age 65 when they become disabled. Social Security replaces 42 percent of their preretirement earnings for such a worker.

Mr. BECERRA. Do you have any sense of what the State and local government plans would replace, generally?

Mr. MULVEY. One of the things we are doing for this Subcommittee, as you know, the several counties in Texas have allowed the unique program, and we are looking specifically as to the disability survivor and retirement benefits for workers who have various earnings histories and who become disabled at various times in their careers and comparing those to Social Security, and we expect to have that out pretty soon, but that work is still preliminary.



Mr. BECERRA. What about the issue of survivor and spousal survivor benefits?

Mr. MULVEY. We were also looking at that and comparing Social Security to those Texas plans, but we haven't finished that work yet.

Mr. BECERRA. Can you give us a general sense of what you're finding?

Mr. MULVEY. We're still doing the analysis, but, obviously, as was pointed out earlier, for those working who are low income and who may be injured earlier in their lives, and so forth, Social Security is probably going to be relatively better for them than the alternative plans.

Mr. BECERRA. What's the best way to respond to someone who's been in a State teacher retirement fund for some time if we should require that now State and local governments participate in Social Security? How do you best respond to those folks who've been in the system for a while?

Ms. FAGNONI. Those entities, those bodies that have proposed mandated coverage as part of the Social Security solvency fix, point to a couple of things: One that the goal—the original goal of the Social Security Program was to aim for universal coverage so that everybody would be covered under one system. There is an issue that some have raised regarding the fairness—and Mr. Bunning alluded to it in his opening statement. People are surprised to learn that not everybody's paying FICA taxes for their careers, so there's that element. We've got 96 percent of the work force already in Social Security covered jobs, and there may be questions from the public about why everybody isn't covered, so there's that aspect of it; the goals of the program; the perceived fairness of having what now end up being a handful of people outside the system. But, on the other hand—

Mr. BECERRA. For that handful that have contributed and would not have the opportunity to collect, if we mandated that they go into a system—from here on in we mandate that people go into the Social Security system, if you're saying to them that it's one or the other—

Ms. FAGNONI. But it would depend on how the States respond to the mandatory coverage requirement, and we've laid out in our testimony some different possible options or approaches that States could take. A State could choose to coordinate the existing pension plan with Social Security to provide a package of benefits that incorporate Social Security features while also maintaining those pension features. So, it doesn't at all mean that they would necessarily lose their current pension benefits although that is a possibility. So, States have various options as to how they respond to this requirement.

Mr. BECERRA. Is there a problem having States respond in various ways and having a system out there that has a myriad of choices and selections by the various States?

Ms. FAGNONI. I would imagine that the question of State choice might get into some issues of State sovereignty, and basically, they don't have a choice in terms of paying the Social Security payroll tax, but beyond that, they do have choices as to how they manage their pension plans.

Mr. MULVEY. And private companies all have different pension plans associated with paying Social Security, so you might get variations among States the same as you get variations amongst private employers.

Chairman BUNNING. The gentleman's time has expired.

Mr. Ensign. No questions?

Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman. Ms. Fagnoni, I'm interested in the constitutional implications, and you discussed the fact that mandating Social Security coverage may present some constitutional issues. Could you highlight these in a little more detail, please?

Ms. FAGNONI. In talking to State and local officials as we've been doing our work, a number of them have said they question the constitutionality of this. There would be court challenges, and they based the questions on the issue of State sovereignty; the authority of the Federal Government to tax States; and the authority of the Federal Government to regulate State employee activities. But our General Counsel's analysis of recent Supreme Court decisions suggest that such challenges would not be upheld; that, in fact, recent court decisions would appear to us to uphold the Federal Government's authority to do this type of mandatory coverage.

Mr. HULSHOF. So, other than, perhaps, the resources that would have to be committed to a court challenge, such a court challenge is likely to fail, at least on behalf of the Governors or the States?

Ms. FAGNONI. That's our assessment based on recent Supreme Court decisions, yes.

Mr. HULSHOF. I want to follow up on what Mr. Becerra was asking about, in particular, mandatory coverage and some of the transition problems and lead time. Now, I know it's tough because you mentioned that different States have—some of them—use a reserve funding approach to finance plans and there are different plans out there, but could you talk just a little about these transition problems as far as lead time and accomplishing this mandatory coverage if we move in that direction?

Ms. FAGNONI. Assuming mandatory coverage occurs, there would be a number of activities that would have to occur for the States to implement this, and some of them would have to be occurring simultaneously that would be fairly complex, because, first of all, it would require that the pension plans and the employers take a look at the plans; determine how they might want to adjust the plans given that there's now Social Security coverage in addition. They would be needing to work with employer and employee groups, because they would have to both be educated as well as have some understanding and buy into the proposals. The State legislatures would have to, ultimately, agree to whatever's proposed in terms of what happens to the State pension plans, and actuaries would have to come up with cost estimates on what these new plans would cost. So, there would be a lot of different plan design and political issues that would have to be addressed and would take some time. To give you some comparison, it took about 3 years for the transition to occur from the CSRS, Civil Service Retirement System, to the FERS Program, Federal Employees Retirement System, for the Federal Government, and for this type of

transition at the State and local level would probably even be somewhat more complex because of all the entities involved.

Mr. HULSHOF. Thanks, Mr. Chairman. I yield back my time.

Chairman BUNNING. Mr. Neal, you do not want to question? OK. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I'm sorry I couldn't be here for all the testimony, but I want to commend the Chairman for having this hearing; another one in a series of hearings about Social Security, and this is an important aspect of it, certainly, for my State of Ohio and for many of us on the panel.

I also have a few questions for our friends at the GAO, Ms. Fagnoni, particularly. I hear sometimes that if we just make Social Security mandatory for new hires that it really won't have any affect on existing plan participants or those folks who have already retired. I know GAO's done some studies on this. Can you tell us what GAO has learned about that?

Ms. FAGNONI. In talking to State and local officials, it is true that the existing plan could continue for the current workers. They might be given the option to go into a newly developed plan that might include Social Security, but I think the issues that people have raised with us are questions that have to do with the fact that the contributions would not be as great in the existing plans, what might happen, and, John, you've got an example—we tried to look for plans where we could make some kind of judgment on how an existing plan might be affected if a new plan were established.

Mr. SCHAEFER. Basically, we've talked not only to the States and localities that have many noncovered workers, but we've also talked to States and localities that have changed their current pensions plans or considered their current pension plans in ways that would be, perhaps, similar to how the States and localities with noncovered workers have to change their plans. There seem to be two basic issues—there are probably more, but at least two. You have to figure out a way to finance their unfunded accrued liabilities. Many of these plans have unfunded liabilities that have to be financed. They are typically financed as a percentage of payroll and as that closed group of employees—if you closed the current pension plan to new members—as that closed group changes, their payroll changes, and it becomes an issue of how to finance the unfunded liabilities.

Mr. PORTMAN. For both those who've already retired and those who are within the State system.

Mr. SCHAEFER. Right, but there are ways—the actuaries do an analysis and they come up with ways to do that, and there are ways to do that. They could finance, for example, as a percentage of total payroll not just the payroll of the closed group of employees. But it is an issue, and at the same time you have costs, percentage of total payroll for all covered and noncovered employees.

Mr. PORTMAN. Even those who are now covered under the new system and paying payroll taxes to the new—

Mr. SCHAEFER. The employer would have—

Mr. PORTMAN. Would it be double?

Mr. SCHAEFER [continuing]. To continue paying the unfunded liability for the current employees as a percentage of payroll. That

unfunded liability doesn't go away because you close the plan to new members.

The second large problem that could occur—and it depends on the plan; each plan is different; has different demographics; it uses different actuarial methods—but a problem that may occur is a liquidity issue. As you close the plan to new members, the contributions go down. You still have people retiring, and those benefits have to be paid. So, you could have a cash flow problem, especially in later years, but at least the actuaries have to analyze that and come up with a way of dealing with it, and that can result in a change in asset allocations, because you have to go through shorter term investments that could reduce your investment income in the out years, so that could be another way of increasing your costs, in essence. But, again, that will depend on each plan; each plan will be different. Some actuaries say that's not a problem; other actuaries say it is. It would be specific to the plan.

Mr. PORTMAN. Thank you. Just a general question: Those of us who are interested in Social Security reform are looking at models around the world, and we've talked about the Chilean model, for instance. I've been down there a couple times, and you learn a lot about their system which is very successful for that country, but there are some different external circumstances when they put that system into effect, and they have a different approach, generally, than we would have on a lot of their investment approaches. But there is something we can learn, I think, from other countries. How about State and local, particularly, State pension plans? Is there something we can learn in your studies from the way the State public plans are working?

Ms. FAGNONI. We have some ongoing work where we're looking at some plans that opted out of the Social Security system right before they could no longer opt out and are looking at how those plans have set up their benefit structures and whether we might learn something from that. That work is underway right now.

Mr. PORTMAN. Is that something GAO plans to issue a report on?

Mr. MULVEY. Yes, it's for this Subcommittee. It's for the Chairman.

Mr. PORTMAN. Chairman Bunning requested it, so you're going to do it, right.

Ms. FAGNONI. That's right.

Mr. PORTMAN. There you go. My time is up. Thank you very much.

Chairman BUNNING. The big thing about Chile, as you all know, they had a benevolent dictator that changed the Social Security. If we had one, we could do it a lot easier too. [Laughter.]

Let me talk to you about the seven major States that have 75 percent of those who are not included. Have you studied the State plans in those seven States to the point of benefits received in direct proportion to those that—and how many dollars have gone in from each employee into those, and what return they've got on their dollar compared to the return on the dollars from the Social Security trust funds?

Ms. FAGNONI. We did not look at that sort of lifetime benefit comparison specifically.

Mr. SCHAEFER. We have work underway on the, basically——

Chairman BUNNING. In other words, you're not finished yet, and you are working on that, and you will have that ready for us? [Laughter.]

Mr. MULVEY. We have a number of studies going on. We have another one looking specifically at the rate of return issue in a more broad sense than simply these seven States.

Chairman BUNNING. It would really help when we get into comparisons, and it would help for us to determine whether we think mandatory requirement is a good thing or bad thing.

I want to let you know that I'm going to submit some questions in writing to each of you so that you can be prepared to respond in writing, so that we can move on to the next panel.

[The questions and answers follows:]

#### Responses of Cynthia M. Fagnoni to Mr. Bunning's Questions

1. You said that most full-time public employees participate in defined benefit pension plans. Do you have information regarding what the average monthly benefit is for these workers?

Answer: Most public pension plans base retirement benefits on the employee's final average salary over a specified period of time, usually 3 years, and both the Department of Labor (DOL) and Public Pension Coordinating Council (PPCC) studies estimate employee retirement benefits as a percentage of final average earnings. Table 1 shows average employee retirement benefits, as a percentage of final earnings, in 1994, for Social Security covered and noncovered state and local government employees retiring at age 62 with 30 years of service.

Table 1: Average 1994 Retirement Benefits in Defined Benefit Plans for Full-time State and Local Employees Retiring at Age 62 With 30 Years of Service

Final salary	Employees covered only by pension plan	Employees covered by Social Security and pension plan		
		Pension plan	Social Security <sup>1</sup>	Total
\$15,000 .....	62%	50%	37%	87%
\$25,000 .....	62	50	31	81
\$35,000 .....	62	50	27	77
\$45,000 .....	62	50	23	73
\$55,000 .....	62	50	20	70
\$65,000 .....	62	50	17	67

<sup>1</sup> Excludes Social Security spousal and dependent benefits.

Source: *Employee Benefits in State and Local Governments, 1994*, DOL Bureau of Labor Statistics, Bulletin 2477, May 1996.

*Follow-up: You cited a DOL study that found that, in addition to retirement benefits, all members of these plans have a survivor annuity option, 91 percent have disability benefits, and 62 percent have some cost-of-living increases after retirement. Are the survivor and disability benefits provided through the basic payroll tax, or is there an additional charge in some or most of these plans?*

Answer: Generally, employer and employee contribution rates for public pension plans are calculated to finance plan benefits, including disability and survivor benefits. However, the most prevalent type of survivor benefit, joint and survivor annuities, requires the retiree to accept a reduced benefit and provides a percentage of that reduced benefit to the spouse upon the retiree's death.

*Follow-up: On the basis of your research, if newly hired state and local government workers were covered under Social Security, would those individuals be better off in terms of total lifetime benefits, given Social Security's comprehensive benefit package (survivors and disability benefits), portability, and inflation protection?*

Answer: Should Social Security be mandated, the effect on newly hired employees would depend on each employee's circumstances and any changes made to current pension plans in response to mandatory coverage. It seems certain, however, that some employees would receive greater lifetime benefits in covered employment. For

example, employees who work for several years in noncovered employment but move to another job before vesting in a noncovered pension plan may be better off with the fully portable benefits offered by Social Security. Similarly, employees who become fully disabled before qualifying for disability benefits under a noncovered pension plan might be better off with the disability benefits afforded by covered employment.

*2. Several plan representatives have told you that the spending increases necessary to maintain level retirement income and other benefits for current and future members will be difficult. These states and localities might decide to maintain current spending levels, which could result in reduced benefits. What kind of benefit reductions might plans be faced with if they have no choice but to cut benefits?*

Answer: A June 1997 actuarial evaluation of an Ohio pension plan concluded that level spending could be maintained if (1) service retirement benefits are reduced (for example, salary replacement rates for employees retiring with 30 years of service would be reduced from 60.3 percent to 44.1 percent), (2) retiree health benefits are eliminated for both current and future employees, and (3) the funding period of the plan's unfunded accrued liability is extended from 27 years to 40 years. The study also stated that additional benefit reductions might be needed to maintain level spending if additional investment income is not available to subsidize pension benefits for newly hired employees.

*Follow-up: In your research, did you check into the current status of the state budgets that would be most affected? So many states, like the federal government, are seeing the benefit of budget surpluses. Could these surpluses assist in paying transition costs?*

Answer: Our review did not include an evaluation of state budgets. However, state and pension plan officials noted that spending for retirement benefits must compete for funds with spending for education, law enforcement, and other areas. In Ohio, for example, officials stated that the state is having difficulty finding the additional funds for education needed to comply with court-ordered changes in school financing. A representative of local government officials in Ohio stated that payroll represents 75 to 80 percent of county budgets, and there is little chance that voters would approve revenue increases needed to maintain level retirement benefits. He stated that the more likely options for responding to increased retirement costs were to decrease the number of employees or reduce benefits under state and local pension plans.

*3. You indicate that one option for states and localities with noncovered workers is to provide newly hired employees with Social Security and pension benefits that, in total, approximate the pension benefits of current noncovered employees. And that studies show that such an option could increase retirement costs by 7 percent of new-employee payroll. A 7-percent of payroll increase in retirement costs for newly hired employees would mean additional costs of about \$5.7 billion over the next 5 years. Is this estimate based on the assumption that all states and localities would select this option?*

Answer: The testimony stated that applying a 7-percent of payroll increase to newly hired state and local employees would result in additional costs to states and localities of \$9.1 billion over the first 5 years, using Social Security Administration (SSA) data and assumptions. The statement assumed that the 7-percent of payroll increase would apply to all states and localities affected by mandatory coverage.

*Follow-up: Under this scenario, employees retiring before age 62 would need to receive a temporary supplemental pension benefit to more closely maintain the benefits of the current plan, correct?*

Answer: Yes.

*Follow-up: Another option for states and localities, if coverage is mandatory, is to provide newly hired employees with pension plan benefits similar to those provided to employees currently covered under Social Security. You point out that retirement costs for states and localities covered by Social Security are higher than the costs for noncovered states and localities—9 percent versus 8 percent in terms of average employee cost rate and 12 percent versus 8 percent in terms of average employer cost rate. Why are these costs so much higher, and given the increased cost, why would states and localities choose this option?*

Answer: As stated in the 1980 study, the cost increase cannot be ascribed to any specific provisions. A major factor is that Social Security provides additional benefits that are not provided by most public pension plans. The 1980 study also noted that

the extent to which the experience of states and localities with covered employees can be generalized to that of noncovered employees is limited because many public pension plans for covered employees were implemented in the 1950s and 1960s when Social Security payroll taxes were much lower. However, employee groups in states and localities with both covered and noncovered pension plans might negotiate for revised retirement benefits that are similar to those of employees in covered plans. Additionally, states and localities with noncovered employees might find it necessary to provide new employees with revised benefits that are similar to those provided to covered employees in neighboring states and localities to remain competitive in recruiting qualified employees.

*Follow-up: In your testimony, you cited a study that showed that most pension plans for covered employees do not provide supplemental retirement benefits for employees who retire before Social Security benefits are available. You also indicated that many employees, especially police and firefighters, retire before age 65. Do most of these police and firefighters try to hang on until age 62—or what happens to these individuals if they must retire earlier than age 62?*

Answer: Our analysis of PPCC data indicates that police and firefighters retired, on average, at age 54 in noncovered plans and age 55 in covered plans. Generally, state and local employees in covered employment would receive a smaller retirement benefit than employees in noncovered employment until they reach age 62 and begin receiving Social Security benefits.

*4. You mention that most states and localities use a reserve funding approach to finance their plans. How does this approach work?*

Answer: Under a reserve funding approach, employers—and frequently employees—make systematic contributions toward funding the benefits earned by active employees. These contributions, together with investment income, are intended to accumulate sufficient assets to cover promised benefits by the time employees retire.

*Follow-up: How many plans have unfunded liabilities?*

Answer: We reported in *Public Pensions: State and Local Government Contributions to Underfunded Plans* (GAO/HEHS-96-56, Mar. 14, 1996) that funding of state and local pension plans has improved substantially since the 1970s. Still, in 1992, 75 percent of state and local government pension plans in a PPCC survey were underfunded. A 1997 PPCC survey indicates that plan funding has continued to improve. The survey report stated that of the plans responding to the question, 51 percent were more than 90-percent funded while only 16 percent were less than 70-percent funded.

*Follow-up: How do these unfunded liabilities occur? Are these plans audited? And how do states determine what corrective action to take?*

Answer: Unfunded liabilities occur for a number of reasons. For example, public plans generally use actuarial methods and assumptions to calculate required contribution rates. Unfunded liabilities can occur if a plan's actuarial assumptions do not accurately predict reality. Additionally, retroactive increases in plan benefits can create unfunded liabilities. We did not review the extent to which public plans are audited; however, for a variety of reasons, we believe most public pension plans are audited on a regular basis. A Government Accounting Standards Board official stated, for example, that many states have legal requirements for plan audits. Unlike private pension plans, the funding requirements of public plans are not regulated by the federal government. States or localities decide how and when unfunded liabilities will be financed.

*Follow-up: Mandatory coverage of newly hired employees would obviously reduce contributions to these funds. What would be the effect on these pension funds?*

Answer: The effect of reduced contributions on plan finances would depend on the actuarial method and assumptions used by each plan, the adequacy of current plan funding, and other factors. Under certain conditions, for example, reduced contributions could affect a plan's liquidity over time, which could, in turn, affect its long-term costs. In 1997, a state legislative committee considered closing the state's defined benefit pension plan to new members and implementing a defined contribution plan. The employees were already covered by Social Security; however, states and localities faced with mandatory coverage might consider making a similar change to their pension plans.

An actuarial analysis found that as the number of employees covered by the plan decreased, the amount of contributions flowing into the plan would also decrease. At the same time, the number of members approaching retirement age was increas-

ing, and benefit payments were expected to increase. As a result, external cash flow would become increasingly negative over time. According to the analysis, the large negative external cash flow would require that greater and greater proportions of investment income be used to meet benefit payment requirements. In turn, this would require the plan to allocate larger proportions of plan assets to cash or lower-yielding short-term assets. Once this change in asset allocation occurred, the plan would find it increasingly difficult to achieve the investment returns assumed in current actuarial valuations, and costs would increase.

*5. In your testimony, you point out SSA estimates that 95 percent of noncovered state and local employees become entitled to Social Security as workers, spouses, or dependents and that 50 percent to 60 percent of noncovered employees will be fully insured by age 62 from covered employment.*

*The Congress established the government pension offset (GPO) and windfall elimination provisions (WEP) to reduce the unfair advantage that workers who are eligible for pension benefits based on noncovered employment might have when they apply for Social Security benefits.*

*Yet the administration of these provisions (government pension offset and windfall elimination provision) is difficult, as you recently reported in a separate study at my request. Would you briefly discuss the key findings of that study?*

Answer: To implement GPO and WEP, SSA needs to know which Social Security applicants and beneficiaries are or will be receiving pensions earned in noncovered employment. For state and local employees, however, SSA has no independent information to identify those who receive pensions from noncovered state and local employment. Generally, SSA is limited to reviewing an applicant's earnings record and asking questions based on that record. As a result, SSA is often unable to verify information provided by the applicant or to detect the subsequent receipt of a pension from noncovered employment. This undermines its ability to determine whether applicants should be subject to WEP or GPO and has led to overpayments. We estimated the extent of overpayments at \$160 million to \$355 million between 1978 and 1995. In the past, SSA considered obtaining pension payment information directly from state and local retirement systems; however, legal and administrative concerns may make this approach impractical. In response to our report, SSA is working with the Internal Revenue Service (IRS) to revise reporting requirements for pension income. IRS believes that a technical amendment to the tax code is needed to allow it to obtain the necessary information. With such information, SSA plans to perform additional computer matches to ensure that GPO and WEP are correctly applied.

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### **Responses of Geoffrey Kollmann to Mr. Bunning's Questions**

*1. Under the government pension offset provision (GPO), how was it determined that two-thirds of a government pension is equivalent to the Social Security benefit the worker would have received if his or her job had been covered by Social Security?*

When the GPO was first enacted in 1977, it provided that 100% of the government pension based on employment that was not covered by Social Security was to be subtracted from any Social Security spousal benefit for which the worker was eligible. Because the purpose of the GPO is to replicate Social Security's "dual entitlement" rule, under which 100% of a benefit earned as a worker is subtracted from the spousal benefit, the notion was implicit that 100% of the government pension is analogous to the Social Security benefit that the worker would have received if his or her job had been covered by Social Security.

Shortly after enactment, opponents of the GPO intensified their criticism of the 100% offset provision. They pointed out that government pensions typically combine the purposes of Social Security and staff pension plans designed to supplement Social Security. While a spouse covered under Social Security may have his or spousal benefit reduced under the dual entitlement rule, the rule takes into account only the Social Security worker's benefit, not the income he or she may have from a private pension. To address these concerns, in 1982 the House of Representatives included in a tax bill affecting the Virgin Islands (H.R. 7093) a modification of the offset provision so that only one-third of the pension would be counted. However, the proposal was dropped in the conference with the Senate version of the bill.

P.L. 98-21, The Social Security Amendments of 1983 (the main purpose of which was to solve Social Security's financing crisis) provided another opportunity to amend the offset provision. As proposed by the House, only one-third of the government pension would be counted in computing the offset. The Senate version of the



Amendments had no such provision. In conference, a compromise was reached where two-thirds of the government pension would be counted, and that became final law. Thus, it does not appear that the determination that two-thirds of a government pension is equivalent to the Social Security benefit the worker would have received if his or her job had been covered by Social Security was based on particular findings or analyses, but as a byproduct of the myriad legislative bargaining involved with enacting urgent and complex legislation.

*Follow-up:* In the Windfall Elimination Provision (WEP), how was it determined that the 90% replacement factor in the benefit formula should be reduced to 40%?

*Follow-up:* In the Windfall Elimination Provision (WEP), how was it determined that the guarantee that the reduction in a government worker's Social Security benefit not be more than 50% of the government pension?

The origin of the WEP was a recommendation by the 1982 National Commission on Social Security Reform (also known as the Greenspan Commission, after its Chairman), that Congress should modify the computation of benefits for workers who receive pensions from non-Social Security covered employment. The Commission, which was established to develop proposals to solve Social Security's looming financial crisis, and whose recommendations were the basis for the 1983 Social Security Amendments, made no specific recommendation on how this revised computation was to be made. When legislation was crafted to put the Commission's recommendation into effect, the Senate version of the WEP lowered the Social Security benefit by substituting a 32% replacement rate for the 90% replacement rate in the Social Security benefit formula. It also included a guarantee that the reduction in Social Security under the WEP could not be more than one-third of the non-covered pension. The House version lowered the Social Security benefit by substituting a 61% replacement rate for the 90% replacement rate in the benefit formula, and specified that the reduction could not be more than one-half of the non-covered pension. In conference, it appears that it was agreed, in effect, to split the difference. The House conferees apparently agreed to accept a lower replacement rate (40%), while the Senate conferees agreed to the guarantee that the reduction could not be more than one-half of the non-covered pension. There is no indication in the record that these provisions were based on particular findings or analyses.

*2. What does research by the Congressional Research Service (CRS) show about the formulas used to determine the GPO and the WEP?*

Because the GPO and the WEP are based on the premise that non-Social Security covered government workers should be placed in approximately the same position as are other workers, CRS has prepared illustrations that show how much of a government pension (i.e., benefits earned under the federal Civil Service Retirement System) is equivalent to a Social Security benefit. It also tried to assess how well the two anti-windfall measures work. It concluded that because the illustrations covered a very wide range, it is difficult to generalize. However, the illustrations did seem to show that for many civil service annuitants the GPO and the WEP are inaccurate. It appears that generally the WEP is appropriate for typical civil service annuitants, but over-penalizes lower-paid workers with short or evenly-split careers, while under-penalizing workers with long Social Security-covered careers. The GPO is basically imprecise, but in many cases this has little effect on considerations of equity. Those likely to be adversely affected by its inaccuracy are surviving spouses of high-paid workers, and those who may partially escape its intended effect are shorter-term, lower-paid workers.

*3. Are there potential problems regarding proposals that restrict the full application of the GPO and WEP to higher-income workers?*

There are three issues involved in such an approach. One is that by applying a form of means-testing to Social Security, it could be criticized as weakening the "earned right" nature of the program. Generally, economic circumstances do not affect Social Security benefits. To do so, opponents would argue, would make the system appear more like welfare and therefore erode its public support.

Another issue is how such an approach could accurately measure economic need. Full means-testing, such as is done in welfare programs like the Supplemental Security Income program, require that recipients submit annually to a full accounting of income and resources. Bills that have been introduced in Congress whose stated purpose is to exempt low-income workers from the GPO and WEP do so by exempting those whose combination of Social Security and government pensions are below a threshold amount. It appears there is a presumption that these two sources of income correlate with low overall income. In fact, using just these two measures of income often can be a poor indicator of a person's economic condition. For example, there could be substantial income from private pensions, assets, royalties, rents, and

earnings (subject, of course to the Social Security earnings test). This caution particularly applies with regard to family income. For example, one member of a couple may have a substantial work history while the other may not. Even if a worker on whose record the Social Security spousal benefit is based is receiving a maximum benefit, reflecting a lifetime of very high earnings, the spouse could still receive higher benefits under this bill if his or her government pension were low (e.g., if the government service were of short duration). Absent some sort of direct means test on total income, there are likely to be instances where families with above-average incomes would receive higher benefits. On the other hand, individuals or families whose incomes consist almost entirely of Social Security and a government pension could get no relief from these bills even though their total income was considerably below average.

Another issue is fairness. For example, in the research done by CRS mentioned earlier on the GPO, one conclusion was that "for short-term, lower-paid government workers, more (emphasis added) than two-thirds of the CSRS pension should be counted in computing the offset. Otherwise, it is possible that spouses of high-paid Social Security-covered workers could receive a higher spousal benefit than they would receive were their government work covered under Social Security." Thus, in regard to workers with low earnings histories, the technical analysis of the report did not agree with the premise that the full application of the GPO and WEP should not apply to lower-income workers. Put another way, from the viewpoint that the goal of the anti-windfall measures is to prevent advantages accruing to government workers that are not available to comparable workers in the private sector, such an approach could create such an advantage.

This is not to say that there are not instances where the GPO and the WEP have the effect of lowering income of already low-income beneficiaries. However, the same effect is produced, often to a larger degree, by Social Security's "dual entitlement" rules and the weighted benefit formula that apply to the population at large (and that the GPO and WEP are designed to replicate). A case might be made that, if the Congress wishes to provide additional benefits to low-income beneficiaries, other means or programs that more accurately measure need and apply to the general population might be more appropriate.

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#### **Responses of Cynthia M. Fagnoni to Mr. Portman's Questions**

*1. In your testimony you stated on page 1 that "Our work shows that mandating coverage for all newly hired public employees would reduce Social Security's long-term financial shortfall by about 10 percent . . ."*

*a. Please define "long-term financial shortfall."*

Answer: Social Security's long-term financial shortfall is calculated as the difference between the present value of revenues and expenditures over a 75-year period, after adjusting for trust fund balances. A 75-year period is used to obtain the full range of financial commitments that will be incurred on behalf of the great majority of current program participants. Table 2 shows the present value of Social Security revenues and expenditures with and without mandatory coverage, over the 75-year period beginning January 1, 1998. The analysis indicates that extending mandatory coverage to all state and local employees would reduce the program's long-term shortfall by 10 percent, from about 2.19 percent of taxable payroll to 1.97 percent of taxable payroll.

Table 2: Present Value of Social Security Revenues, Expenditures, Payroll, and Actuarial Balance Over 75 Years With and Without Mandatory Coverage (Dollars in Billions)

	Without mandatory coverage	With mandatory coverage	Change
Beginning trust fund balance .....	\$655.5	\$655.5	\$0.0
Present value of total revenues .....	18,413.4	18,934.6	521.2
Present value of total expenditures .....	21,983.0	22,274.7	291.7
Revenue minus expenditures .....	(3,569.6)	(3,340.1)	229.5
Target trust fund balance <sup>1</sup> .....	185.4	192.7	7.3
Actuarial balance .....	(\$3,099.5)	(\$2,877.3)	222.2
Present value of taxable payroll .....	\$141,779.0	\$145,878.9	4,099.9
Actuarial balance as a percent of payroll .....	(2.19)	(1.97)	0.22

<sup>1</sup> The target trust fund balance is an amount equal to the following year's projected expenditures.  
Source: SSA, Office of the Chief Actuary.

*b. Please specifically state all economic, demographic, and other assumptions used in determining a 10-percent reduction in this "shortfall."*

Answer: SSA assumed that mandatory coverage would become effective on January 1, 2000, and that the existing noncovered workforce would be replaced by covered employees at a rate similar to that experienced by states and localities affected by the extension of mandatory Medicare coverage to public employees hired after March 31, 1986. SSA's analysis used the intermediate demographic and economic assumptions detailed in the Board of Trustees' 1998 annual report. The intermediate assumptions represented the Board's best estimate of the future course of the population and the economy. Table 3 shows the ultimate values for the intermediate assumptions that apply to years after 2023.

Table 3: Ultimate Intermediate Economic and Demographic Assumptions Used in the Board of Trustees' 1998 Annual Report

Assumption	Ultimate value
Annual percentage change in:	
Average wage in covered employment .....	4.4
Consumer Price Index .....	3.5
Real wage differential (percent) .....	0.9
Unemployment rate (percent) .....	6.0
Annual interest rate (percent) .....	6.3
Total fertility rate (children per woman) .....	1.9
Life expectancy at birth in 2075 (combined average for men and women) <sup>1</sup> .....	81.7
Net annual immigration (thousands) .....	900.0

<sup>1</sup> Life expectancy is assumed to continue improving throughout the projection period.  
Source: Social Security Board of Trustees Annual Report for 1998.

*c. Can you explain what part of the 10-percent reduction is attributable to reduction in administrative expenses?*

Answer: SSA assumed that mandatory coverage would not affect overall administrative costs over the 75-year period.

*d. How will mandatory coverage reduce or simplify program administration?*

Answer: Should coverage be mandated, eventually all state and local employees with the exception of a few categories of workers, such as students and election workers, would be in covered employment. Over time, this would reduce the number of potential adjustments under GPO and WEP. Additionally, the SSA Inspector General has reported that Social Security provisions related to the coverage of state and local employees are complex and difficult to administer and that there is a significant risk of sizable noncompliance with state and local coverage provisions. SSA and IRS have initiated an effort to educate employers and ensure compliance with legal requirements for withholding Social Security payroll taxes. Extending coverage to all newly hired state and local government employees would, over time, greatly reduce or eliminate this problem.

2. *Other panels that appeared before the subcommittee testified that compound interest is a vital part of their systems' funding. What increase would be necessary in the interest rate paid by the U.S. Treasury to SSA to achieve the same 2-year funding period extension as mandatory coverage for new hires would provide?*

Answer: According to SSA's Office of the Chief Actuary (OACT), if the real annual interest rate earned by the trust funds is increased by 0.7 percent over the 75-year period, then the year of exhaustion would be extended an extra 2 years, achieving the same period of extension as the provision to cover newly hired state and local government employees beginning in 2000. The increase in annual rates begins in 1998 and is assumed for all bonds held by the trust funds. The ultimate real interest rate would be 3.5 percent, rather than 2.8 percent, as assumed in the 1998 Board of Trustees' report.

3. *As you are aware, mandatory coverage has been extended to other groups over the decades. Please provide us with evidence of the effect this has had on the reduction of the shortfall for each of these extensions and the increase in liabilities to Social Security.*

Answer: In addressing cost increases between 1940 and 1971, the 1972 annual report of the Board of Trustees stated that the extension of coverage to new workers had had an upward effect on both costs and taxable payroll and, in most cases, had not materially affected program costs as a percentage of taxable payroll. During the period, however, expanded coverage was not limited to newly hired employees. As a result, experience through 1971 may not be relevant to an evaluation of the potential financial effect of expanded coverage that is limited to newly hired employees.

Mandatory coverage has been extended to several groups since 1971, including federal employees hired after December 31, 1983. In recommending the extension of mandatory coverage to nonprofit and newly hired federal employees, the National Commission on Social Security Reform estimated a long-range savings of 0.30 percent of payroll. According to a representative of SSA's OACT, OACT has not estimated actual program income and costs with and without the federal employees hired after December 31, 1983, or for any other groups that were added.

4. *In your testimony you stated:*

*"For most of the examined pension plans, the present value of lifetime benefits for employees covered by Social Security would be greater than the value of benefits for current noncovered employees." (page 8)*

*"We did not compare the expected value of total lifetime benefits for covered and noncovered employees because amount would vary depending on the benefits offered by each plan." (page 9)*

*These statements are contradictory. What is the factual and financial basis upon which the conclusion in the first statement was made?*

Answer: The statement on page 8 refers to the 1980 study performed by the Universal Social Security Coverage Study Group, which analyzed a large number of plans in depth. We did not replicate the 1980 study and calculate the expected value of lifetime benefit offered by current pension plans.

5. *In your written testimony, you refer to seven states that have a majority of non-covered workers. Is it true that other states such as Nevada, Alaska, Connecticut, and Kentucky have significant percentages of workers who are not covered by Social Security? What would the effect on systems that have high percentages of public employees not covered by Social Security?*

Answer: SSA estimates that more than 50 percent of state and local government employees are not covered by Social Security in Alaska (59 percent), California (51 percent), Colorado (63 percent), Louisiana (71 percent), Maine (54 percent), Massachusetts (86 percent), Nevada (66 percent), and Ohio (92 percent). Other states have lower percentages of noncovered employees. The effect on the pension plans in these states would depend on how state and local governments with noncovered employees respond to the additional costs and benefits associated with Social Security coverage.

6. *As a response to a question about how noncovered systems would plan for changes brought about by mandating coverage, the reply essentially was that it would depend on the actuarial method used by the plan. To a small extent that is a factor, but the real issue is how plans would deal with significant reductions in the stream of income necessary to continue the plans as they are now constituted. Please provide greater detail on how large noncovered plans would be affected costwise and the extent to which current active members and retirees would also be affected.*

Answer: The effect of reduced contributions on each plan's finances would depend on a number of factors. However, reduced contributions to current plans could adversely affect the liquidity and ultimately increase the cost of some plans. In 1997, for example, a state legislative committee considered closing a defined benefit pension plan to new members and implementing a defined contribution plan. State employees were already covered by Social Security; however, states and localities faced with mandatory coverage might consider making a similar change to their pension plans. An analysis of the proposed change stated that as the number of employees covered by the plan decreased, the amount of contributions flowing into the plan would also decrease. At the same time, the number of members approaching retirement age was increasing, and benefit payments were expected to increase. As a result, external cash flow would become increasingly negative over time. In turn, this would require the plan to allocate larger proportions of plan assets to cash or lower-yielding short-term assets. Once this change in asset allocation occurred, the plan would find it increasingly difficult to achieve the investment returns assumed in current actuarial valuations, and costs would increase.

The implications for current active members depends on how states and localities respond to the increased costs. According to an analysis by the Public Retirement Institute, however, most state and local government pension plans are covered by provisions that would preserve benefits for current employees. The benefit guarantees cover benefit formulas, vesting, purchase of service credit, benefit rights, and any other provision provided in the pension agreement. The guarantees are enforced through the courts. According to information provided by the Government Finance Officers Association, for example, there are implicit or explicit restrictions against benefit reductions for employees in Alaska, California, Colorado, Louisiana, and Nevada, among others. Employees in states that permit benefit reductions for active employees would need to rely on the process for changing benefits to safeguard current benefit levels.

*7. The Third Millennium Report entitled "The Consequences of Non-FICA Status on State and Local Pension Plans" clearly states that noncovered employees can expect a much higher rate of return on contributions and that non-FICA plans are advance funded. Further, non-FICA plans have a much higher rate of return on their investments. When asked a question during the hearing about what could be learned from these large state plans, the reply was directed to an ongoing study of three Texas counties. While those results in those counties may be interesting, the real question still remains. What did you learn from your studies by these large state plans that the subcommittee should take into consideration as we move to reform the Social Security program?*

Answer: For the most part, public pension plans are reserve funded. Under reserve funding, contributions are made toward the present value of benefits earned by active employees, which, together with investment income, are intended to accumulate sufficient assets to cover promised benefits. According to the Bureau of the Census, state and local pension plans had accumulated assets of more than \$1 trillion in 1994. Additionally, pension plans allocate these assets among several asset classes, including domestic and international stocks, and the rate of return on plan assets plays a significant role in plan funding. The Bureau of the Census estimates that, in 1994, investment income amounted to about 61 percent of total income for state and local pension plans. According to a 1997 PPCC survey, the annual investment return for responding plans averaged 13.7 percent in 1996 and 11.3 percent in the 5-year period from 1992 to 1996.

Social Security, in contrast, is financed mostly on a pay-as-you-go basis. Under pay-as-you-go financing, the payroll taxes of current workers are used to pay the benefits of current retirees and program assets are few relative to accrued liabilities. Additionally, federal law limits Social Security investments to interest-bearing securities of the U.S. government or securities guaranteed by the United States. As a result, in 1997, investment income amounted to about 9.6 percent of total income, and the program received an effective annual interest rate of 7.5 percent on its investments.

Extending mandatory coverage to state and local employees would involve a trade-off between the higher investment returns earned by public retirement systems and the expanded portability, inflation protection, and dependent and other benefits provided by the Social Security program. Additionally, Social Security reform proposals generally include provisions for expanding Social Security reserves and investing some of the trust funds in additional asset classes. We addressed issues related to advanced funding and diversifying Social Security investments in *Social Security: Different Approaches for Addressing Program Solvency* (GAO/

HEHS-98-33, July 22, 1998). We also have an assignment under way to address the extent to which workers receive their money's worth from Social Security.

*8. Your testimony indicates that bringing in new hires in noncovered systems would only extend the solvency of Social Security by 2 years. Yet the damage to noncovered systems by this action would be severe. Why was the 2-year factor minimized so much in your report?*

Answer: We focused on Social Security's actuarial deficit over a 75-year period because that is the measure of financial solvency used by Board of Trustees in its annual reports. Additionally, we focused on the 10-percent reduction in the actuarial deficit attributed to mandatory coverage of state and local government employees because that was the method used by the 1994-96 Social Security Advisory Council to measure the effect of mandatory coverage on that deficit.

We showed that mandatory coverage would extend Social Security's solvency by 2 years, assuming no other adjustments, to emphasize the fact that mandatory coverage would resolve only a portion of the Social Security financial shortfall and must be coupled with other adjustments to fully resolve Social Security's actuarial deficit over the 75-year period. Within a final package of adjustments designed to fully eliminate Social Security's actuarial deficit, extending Social Security to state and local employees would eliminate 10 percent of that deficit.

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Chairman BUNNING. I want to thank you for your testimony.

Our next panel includes Robert Scott, Richard Schumacher, and Sergeant Martin Pfeifer, Thomas Lussier—is that right?

Mr. LUSSIER. Correct.

Chairman BUNNING. Mr. Scott is the executive director of the Public Employees' Retirement Association in Denver, Colorado. He will be testifying on behalf of the Coalition to Preserve Retirement Security. Mr. Schumacher is the executive director of the Public Employees' Retirement System of Ohio. Sergeant Pfeifer is with the Washington Metropolitan Police Department and a Trustee on the National Board of the Fraternal Order of Police. Mr. Lussier is the executive director of the Massachusetts Teachers' Retirement Board. And I want to recognize my fellow Ways and Means Committee Member, John Ensign, to introduce the final witness on this panel.

Mr. ENSIGN. Thank you, Mr. Chairman. I also want to thank you for holding this hearing and inviting me to be here, and I want to especially thank you for allowing one of the experts from my home State of Nevada, George Pyne. George is the executive officer of the Public Employees' Retirement System of Nevada, and he's joining us this morning to share, I think, what you'll find is very important testimony.

I've been a fan of George's and what he's done with the State of Nevada. I use it in many, many speeches and talk about it as an example of one of the things that could possibly be done for the future of Social Security, and because they take advantage of that magical thing called compounding, and it's something that we should be teaching in our schools, because most people don't understand that growing rich slowly over time because of compounding really works, and the State of Nevada and their retirement system, I think, is a very, very good example of how it can be done. So, I appreciate your allowing me to introduce Mr. Pyne this morning, and I know that you'll be pleased with his testimony.

Chairman BUNNING. Thanks, John. Before we begin this panel, I'd like to point out that despite our best attempts we were unable

to obtain witness representing the 1994–96 Social Security Advisory Council. Edith Fierst who served on the Advisory Council has provided a statement for the record.

Mr. Scott, would you please begin.

**STATEMENT OF ROBERT J. SCOTT, SECRETARY TREASURER,  
COALITION TO PRESERVE RETIREMENT SECURITY; AND  
EXECUTIVE DIRECTOR, PUBLIC EMPLOYEES' RETIREMENT  
ASSOCIATION, DENVER, COLORADO**

Mr. SCOTT. Thank you, Mr. Chairman. My name is Bob Scott, and, as you said, I'm executive director of the Public Employees' Retirement Association. We manage \$25 billion in assets for almost 200,000 members, retirees, and beneficiaries. I'm testifying today as secretary treasurer of the Coalition to Preserve Retirement Security, formerly known by the acronym of OPPOSE. This coalition represents the interests of some 5 million public employees and retirees who do not participate in Social Security.

The Coalition to Preserve Retirement Security believes that the Social Security system has provided and continues to provide an important part of the retirement benefits for the majority of American workers, including many of our colleagues in public service. We also believe that it is critical that the Social Security Program be preserved and strengthened and we applaud the bipartisan work now being done by Congress to effect changes which will enhance the long-term stability of Social Security.

You are here today to consider one possibility for change. This possibility, extending mandatory participation to public service positions not now covered, is in terms of the total package of possible changes very small. However, it is an issue of critical importance to the affected employees and employers.

I'd like to very briefly suggest to you four reasons—and we think they're very strong reasons—why you should focus on other possibilities. First, the current structure works and it works well. The Amish say, "If it ain't broke, don't fix it." I would say, "If it ain't broke, don't break it." In 1990, Congress required that all public employees be provided with retirement plans that either included participation in Social Security or provided comparable security and benefits independent of Social Security. In the written materials, I've provided you with data showing that existing public plans independent of Social Security provide sound, well-funded programs which include good retirement, disability, cost of living, and survivor benefits at a very reasonable cost to the public employer and, thus, to the taxpayer. To radically alter these sound, efficient plans by imposing mandatory participation would force major plan redesigns and require that either employer costs go up, benefits go down, or both.

Second, the proposal goes against the grain of one of the critical foundations of many of the restructuring programs; that is to enhance the long-term viability of Social Security. While mandatory coverage of new hires would provide a short-term increase in cash receipts by a small amount—0.2 percent of pay—it would increase the long-term liabilities of programs just at the time when current projections show that the revenues will become insufficient. The current concerns with the long-term viability of Social Security are

not the result of noncoverage of some public workers, and their mandatory inclusion cannot help resolve these concerns. In short, we have not been a part of the problem, and our inclusion cannot, in reality, contribute the solution.

Third, inclusion of noncovered public workers will, in fact, distract from the development of effective ways to address the fundamental needs of Social Security. As I noted earlier, inclusion would adversely affect 5 million workers and retirees and their families as well as thousands of public employers. Naturally, this will foster opposition to change on their part. As I said at the outset, we support Social Security as a general program and want to help develop effective ways to ensure its long-term strength. If mandatory participation is not an issue, this group can join with you and your colleagues to work for positive and effective change.

Finally, mandatory inclusion would add to the one of the fundamental concerns with Social Security as it now exists. At its inception, it was possible and practical for Social Security to use current workers' earnings to pay for former workers' retirement benefits. However, we are all painfully aware of the major demographic changes that are still in progress and which have made this form of intergenerational transfer both inequitable and impractical. We should not add to this inequity by creating an even greater future unfunded liability. Let's not put more passengers on the Titanic. Let's work together to find a way to avoid the iceberg.

In summary, we want to support effective change to enhance the long-term viability of Social Security. In that context, we can see no basis to support mandatory coverage of public workers who are now covered by sound, well-funded State and local plans that should not be replaced, but rather looked to as examples. Thank you.

[The prepared statement follows:]

**Statement of Robert J. Scott, Secretary Treasurer, Coalition to Preserve Retirement Security; and Executive Director, Public Employees' Retirement Association, Denver, Colorado**

My name is Robert J. Scott. I am Secretary/Treasurer of The Coalition to Preserve Retirement Security ("CPRS"). CPRS is a Colorado Corporation formed by teachers, fire fighters, police officers, and other state and local government employees who elected not to join the Social Security system. The purpose of our organization is to assure the continued financial integrity of our members' retirement and health insurance plans by resisting efforts to mandate Social Security coverage of public employees. Our members are found in Alaska, California, Colorado, Connecticut, Illinois, Kentucky, Louisiana, Massachusetts, Minnesota, Nevada, Ohio, and Texas. With respect to mandatory Social Security coverage, the interests of CPRS are identical to those of approximately five million public employees throughout the nation who remain outside the Social Security system, as well as over one million retirees from public retirement plans outside of Social Security.

**BACKGROUND**

For many years after the Social Security system was created, state and local government employees were not allowed to participate in the system. Beginning in the 1950s, state and local government employers could elect to have their employees covered. Governments which elected in were also permitted to opt out again, after notification of the intent to do so, and the expiration of a two year waiting period.

This was the law for about three decades, until, in 1983, there was a major revision of the Social Security and Medicare laws, triggered primarily by a concern about the long term solvency of these two trust funds. Congress decided not to require state and local employees who were outside the system to be covered, but did end the opt out for public employees who had chosen to be covered. An "anti-



windfall" rule was adopted, to ensure that public employees who were covered by Social Security and by a public plan did not receive excess credit for Social Security purposes.

In 1986, as part of the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), Congress determined to require participation in the Medicare system on a "new hires" basis, but chose to leave public employee retirement plans in place, and did not change the law with respect to Social Security.

In 1990, Congress enacted a law requiring that all public employees not covered by a state or local retirement plan meeting specified standards must be covered by Social Security. That law, adopted as part of the Omnibus Budget Reconciliation Act of 1990 (the "1990 Act"), ensures that all public employees will be covered either under Social Security or under a public retirement plan which provides comparable benefits. This has proven to be an effective and workable approach. Today, about one-third of all state and local government employees, about five million people, are outside the Social Security system because they are covered by public retirement plans. Additional millions are retirees from non-Social Security public plans, who are dependent on those plans for all, or most, of their retirement income.

#### BACKGROUND OF THIS HEARING

Reasonable people differ about the date when serious trouble really begins for the Social Security system. Although nominally established like a funded pension system, in practice, Social Security Trust Fund surpluses have been used to reduce operating deficits in other parts of the federal budget. There is an obligation for the Treasury to repay these "borrowings" from Social Security, but the federal government will not be able to repay these borrowings when the time comes, except by creating surpluses in other parts of its budget, or by printing money.

In his 1998 State of the Union address, President Clinton proposed a policy of "save Social Security first," by which he meant that until such time as the President and Congress agree on a method to put Social Security on a sound footing for the foreseeable future, all federal budget surpluses must be applied to preserve the Social Security system. This proposal has enjoyed considerable support on both sides of the aisle in Congress.

When Social Security outlays begin to exceed Social Security revenues, this will place an additional burden on the federal budget, as Social Security becomes a net importer of general federal revenues. If the federal operating budget is in a healthy posture, Social Security payments could be made out of general federal revenues, gradually repaying the Social Security Trust Fund for amounts lent to the federal government to cover operating deficits in the past. On the other hand, if the federal operating budget is in deficit, then repaying the Social Security Trust Fund will be very difficult. Proposals to solve the long term Social Security funding problem by increasing current Trust Fund revenues are doomed to failure unless those Trust Fund surpluses are used in such a way as to reduce future demands on the general fund. (In fact, increases in current Trust Fund surpluses could actually make the long term situation worse, if the current surpluses are not saved and additional obligations to pay future benefits are incurred.)

In 1994, the Bipartisan Commission on Entitlement and Tax Reform (also known as "the Kerrey-Danforth Commission") studied the problem of projected short falls in the Social Security and Medicare Trust Funds, as well as other mid-term and long-term deficit problems. The Commission was unable to agree on a set of recommendations, but did valuable work in assessing the dimensions of the problem. In an interim report published in August, 1994, the Commission projected that with no changes in law, by 2010 entitlement spending and interest on the national debt would consume almost the entire federal revenues; by 2020, entitlement spending alone would almost equal the federal revenue stream; by 2030, there would not be enough revenue to service the federal entitlement obligations, even if no money were used for other purposes, including payment of interest on the national debt.

In 1995 and 1996, The Advisory Council on Social Security examined the mid-term and long-term solvency of Social Security and the Social Security Trust Fund. The Council submitted its report in January, 1997. Once again, there was no majority on the Council for any single set of recommendations. Three different proposals were put forth by different groups of members. A majority of the Council recommended mandatory Social Security coverage of public employees, although the three labor members of the Council opposed this proposal "because of the financial burden that would be placed on workers and employers who are already contributing to other public pension systems."

These hearings are being held to consider the advantages and disadvantages of mandatory Social Security coverage of public employees as a partial solution to the long-term funding problems of Social Security.

MANDATORY SOCIAL SECURITY COVERAGE IS WRONG AND SHOULD NOT BE ADOPTED

*1. Public employees are well provided for under their public plans; mandatory Social Security coverage will harm public employees as well as people who have retired from non-Social Security public plans.*

Public plans do an excellent job of providing retirement security for their members. Analyses done by public plan fiduciaries indicate that public employees of almost any description (in terms of salary, length of services, etc.) are better protected under their public plan than they would be under Social Security. For example, the Public Employees Retirement Association ("PERA") of Colorado produced a study (assuming retirement in 1998 at age 62) showing that an employee working ten years with a highest average salary of \$15,000 per year, would receive a Social Security benefit equal to 20.6 percent of pay; the PERA employee would receive a benefit of 22 percent. For short term employees with higher average rates of pay, Social Security benefits are proportionately much lower. For example, a ten year employee with a highest salary of \$60,000 per year would get a benefit of 11.8 percent under Social Security; his PERA benefit would be 22 percent.

Longer term employees at all rates of pay have more secure retirements under PERA. A fifteen year employee earning a highest average salary of \$15,000 would receive 28.6 percent of pay under Social Security—33 percent under PERA. A twenty year \$15,000 per year employee would receive 32.4 of pay under Social Security—fifty percent of pay under PERA. At thirty years of service, this hypothetical, relatively low pay (\$15,000 per year) employee would receive 42.6 percent of pay under Social Security, but 75 percent of pay under PERA. At forty years of service, the respective numbers are 49.5 percent of pay under Social Security; 100 percent for PERA.

PERA of Colorado is a good plan, but analyses of other public plans prove that these plans also do an excellent job for their employee-members. A comprehensive study of public plans, prepared under the sponsorship of Third Millennium, entitled "Freed From FICA: How Seven States and Localities Exempt a Million Employees from Social Security and Provide Higher Pension Benefits to Retirees" (March 1997) (the "3rd Mill Report") compares the benefits provided under seven large public plans with those provided under Social Security. An employee retiring after 40 years of work at age 65 with an age 62 salary of \$20,000 would receive an annual pension of \$22,153 from the Public Employee Retirement System ("PERS") of Nevada; \$17,722 from the State Teachers' Retirement System ("STRS") of California; \$18,609 from PERS of Ohio; \$18,609 from STRS of Ohio; \$20,118 from the Los Angeles City Employees' Retirement System; and \$17,722 from the Maine State Retirement System. The average for the seven plans studied was \$18,951. The Social Security benefit for a worker with the same background would be \$8,617 for a single worker and \$12,926 for married workers. As salary levels rise, public plans do an even better job for their workers in relation to Social Security.

Relatively low paid workers need a high return on their retirement savings in order to be able to retire with dignity. It is small consolation that the percentage return for low paid workers is relatively generous under Social Security, if the dollar benefits are low. For this reason, low paid workers are among those most adamantly opposed to trading all or a substantial part of their current retirement benefits for Social Security coverage. For example, the School Employees' Retirement System of Ohio, with average member compensation of less than \$15,000 annually, has been a member of CPRS, and a strong opponent of mandatory coverage, for almost two decades.

The Social Security Advisory Council argues at pages 19–20 of its report that "over the course of a lifetime, it is impossible to tell who will and who will not need [Social Security] coverage." The Council suggests that Social Security may be superior to state or local plans because of the inflation proof aspect of Social Security, or because of the spousal benefit and other ancillary benefits, or because of Social Security's portability.

These claims are not supported by facts. It is not the case, for example, that Social Security benefits are guaranteed. At the time of the 1983 reform, Social Security benefits were reduced, most importantly, by increasing the normal retirement age for Social Security on a phased-in basis. More recently, Social Security benefits were made taxable for some recipients. Social Security's companion program, Medicare, has also been the subject of many cost control measures. Current pressures

on the funding of Social Security may quite possibly result in further benefit reductions.

Social Security benefits are reduced for earnings of beneficiaries above specified levels until the beneficiaries reach age 70. Public plan benefits are generally not reduced for earnings.

All of the plans surveyed in the 3rd Mill Report provide disability benefits, as do the vast majority of public plans. The disability benefit provided by Social Security is hard to qualify for. (Generally a worker must be unable to perform any substantial gainful activity and the impairment must have lasted, or must be expected to last, for at least 12 months.) Public plans are often more generous. The average disability benefit provided by the seven surveyed plans was \$10,440 annually.

All of the plans surveyed in the 3rd Mill Report provide pre-retirement survivor benefits, as do public plans generally. (Six of the seven surveyed plans also provide post-retirement survivor benefits.) For children, Social Security's survivor benefits cease when the child turns 18. Many public plans provide benefits after that age has been reached if the child is a full time student. The average survivor benefit paid by the seven surveyed plans was \$6,960 annually.

Social Security provides an annual cost-of living adjustment for its beneficiaries and so do public plans. The seven surveyed plans all provided cost of living adjustments. During the period from 1988 to 1992 (when inflation was largely under control) these adjustments tended to average slightly over three percent per year. (3rd Mill Report, page 16) Public plans, in effect, also provide very high pre-retirement cost-of-living adjustments, because public plan retirement benefits are almost always based on the final or highest years of compensation (generally a three-year or five-year period is used for the benefit computations).

The greatest advantage of Social Security is supposed to be its portability. Social Security benefits are 100 percent portable after the 40 qualifying quarters have been earned. This is particularly supposed to be an advantage for people who move in and out of the work force. But Social Security benefits for people who have limited years of service may be low, even if those benefits are vested. No refunds are paid by Social Security, even to workers who have less than 40 quarters. Most public plans provide rapid vesting. All but one of the seven surveyed plans in the 3rd Mill study vest in five years, and the plan average for all seven plans was 5.71 years. Of course, public employees are always 100 percent vested in their own contributions and may roll those contributions over into an IRA if no better option is available.

Most public plans afford considerable portability, even with regard to employer contributions. Many plans allow transfer of credits within the same state. Many plans also have buy-in provisions whereby employees may purchase credit in a retirement system, often with proceeds from credits earned in another retirement system.

In the future it is highly likely that portability provisions will be even better. There is currently pending before the Congress the Retirement Account Portability Act of 1998, which appears to enjoy substantial support. This proposal will facilitate roll overs between different kinds of defined contribution plans and will also make it easier for workers to roll over amounts from their IRAs into employer plans.

It is also the case that the Social Security system is not well designed to meet the needs of certain public employees, particularly fire and police. Because of the physical and emotional stress caused by their members' work, fire and police pension plans generally have generous disability benefits. Also fire fighters and police officers retire earlier than most other categories of worker, because physical conditioning is such an important part of job qualifications. In addition, fire fighters particularly have an average life expectancy which is significantly below that of the general population (primarily because of fire fighter's exposure to hazardous materials). The rate of return from Social Security for many fire and police workers would be far below average.

Some studies have also indicated that Social Security may have a poor rate of return for minorities. Governments are generally strong proponents of equal opportunity and employ significant percentages of African American, Hispanic, and other minority workers. These employees, like their non-minority colleagues, receive excellent retirement benefits. Many public plans provide several optional retirement packages to their employees when they retire, while Social Security provides only a life time annuity.

A January 1998 report by The Heritage Foundation entitled, "Social Security's Rate of Return," indicates that a low-income worker (average annual earnings of \$12,862) born in 1975 can expect a life time rate of return of about negative one percent, for a net loss of \$13,377. A large part of this negative rate of return is attributable to the relatively short life expectancies of African-Americans. African-

American women generally have a positive rate of return, but nonetheless receive far less than they would obtain from even very conservative investments of their Social Security contributions. The report concludes that "Social Security taxes impede the inter-generational accumulation of capital among African-Americans...."

Some people make the mistake of thinking that if mandatory Social Security coverage is applied on a new hires basis, then retirees and current plan participants will not be hurt. This is not the case. Public plans provide most of their benefits not from employer and employee contributions, but from investment earnings on those contributions. For example, in the Ohio STRS plan, about two-thirds of all plan benefits are paid from plan earnings. Applying Social Security taxes to new hires will reduce the capital stream upon which the earnings are based. How fast this would happen depends on factors which cannot now be determined. The most important of these factors is the definition of a "new hire." If the term is defined conservatively, employee turnover would occur at a rate of about six to seven percent per year. If the COBRA definition of a "new hire" for Medicare purposes were to be used (many people who change jobs even within the same government system are considered to be new hires), the turnover rate would be a great deal higher, at least during the initial years of the new system.

Ohio STRS has concluded that mandatory coverage of new hires would result in the loss of the medical plan which STRS now provides to members and retirees. In addition, STRS believes that it will be necessary to (1) eliminate death, disability and survivor benefits; (2) reduce cost-of-living adjustments from 3 percent annually to 1.6 percent; or (3) reduce retirement benefit accruals from 2.1 percent to 1.9 percent for current members, and from 1.47 percent to 1.32 percent for future members.

These changes are highly injurious and would fall most heavily on those already retired, who would not be in a position to easily adjust. Retirees live throughout the nation. This means that mandatory coverage, even on a new hires basis, would impact people in every state, and would create additional burdens for state and local governments throughout the nation, especially in those states which are home to large numbers of retirees.

*2. Mandatory Social Security Coverage of Newly Hired Public Workers Will Not Save the Social Security System; Nor Will Mandatory Coverage Significantly Reduce the System's Problems.*

The Social Security system is not in short-term trouble. Currently surpluses in the Social Security system are being used to fund operating deficits elsewhere in the federal budget, although there is now wide spread support for stopping this practice.

The Advisory Council on Social Security expresses the actuarial deficit over the 75 year period ending in 2070 in terms of a percentage of payroll, i.e., 2.17 percent. (Advisory Council Report, p. 11) In dollars, the present value of the difference between OASDI current assets, plus OASDI tax and interest for the 75 year period, minus the present value of OASDI obligations is minus two trillion, five hundred and twelve billion. (Advisory Council Report, p.198). In cash flow terms the Advisory Council expects tax receipts to exceed outgo through 2014. Beginning in 2015, Social Security will run a small cash deficit, but growing each year, so that the short fall for the year 2030 will be \$611 billion, and the cumulative short fall for the period 2015 through 2030 is estimated at \$4,512,000,000,000 (about four and one half trillion dollars). (Advisory Council Report, p. 192) Estimates of the total long term shortfall are in the range of \$9 trillion. (There are, of course, other unfunded federal liabilities, including Medicare and interest on the national debt, as well as other entitlements.) But the favorable economic trends which have occurred since this report was prepared have almost certainly postponed the year when cash flow problems will begin, and reduced somewhat the extent of the long term actuarial deficit.

In their April, 1998 report, the Social Security and Medicare Boards of Trustees announced that the OASDI Trust Fund would remain viable through 2032 (an improvement of three years over previous projections). Also, the Trustees now project that Social Security will continue to generate surpluses through 2013 (an improvement of one year). OASI, by itself, will remain viable for several additional years. The Trustees indicated, at page seven of their report, that "key dates are 1 to 4 years later than shown in the 1997 report, due in large part to better actual and expected economic performance." In the several weeks since the publication of the Trustees' Report, the economic situation has improved still further. On May 5, 1998, the Congressional Budget Office increased its surplus projection for fiscal years 1998 and 1999 from \$28 billion, to a range of between \$73 and \$93 billion.

The Advisory Council estimates that in terms of a percentage of payroll, mandatory coverage of new hires, beginning January 1, 1998, would save about 0.22 percent, or about ten percent of the total actuarial deficit for the period 1995 through

2070. This is largely because cash from new hire taxes would come into the system before the obligation to pay out benefits materialized. Of course, the obligation to pay out benefits with respect to contributions made before 2070 would continue long past that year.

In order to determine how to repair Social Security, it is necessary to understand what is wrong now. Although there may be many problems with Social Security, by far the most important is that the system has tried to operate on a pay-as-you-go basis. This approach worked without great strain so long as national demographics were favorable, and the pool of workers was growing much more rapidly than the pool of retirees. This was the case for many decades, but it is no longer the case.

Although there is a large Social Security Trust Fund, which will keep Social Security in actuarial balance through about 2032 (perhaps slightly longer), this trust fund consists of money which the federal government has promised to repay to itself in the future. When Social Security obligations begin to exceed tax revenues, there is no box of money that the government can go to in order to make up the short fall. The federal government can either print money, thereby fueling inflation, or repay the Social Security Trust Fund out of an operating surplus in the rest of the federal budget.

There is a third choice, which is to invest the current Trust Fund surplus in assets which may be redeemed later. This has not been done in the past, but there is no insurmountable obstacle to undertaking such a policy in the future. For example, current surpluses could be used to pay down the national debt (thereby making it easier to create operating surpluses in the future), or by having the federal government invest in stocks and bonds, or by the creation of personal savings accounts which, in the future, would reduce workers' claims on the existing Social Security system. There are problems and advantages in connection with all of these approaches. But until the federal government faces up to the fundamental difficulties of the pay-as-you-go approach, Social Security's funding problems can only be solved on a pay-as-you-go basis, which means, for years in which outgo exceeds revenues, that benefits must be cut or taxes must be increased.

Many ideas have been advanced in connection with funding Social Security. Reducing the cost-of-living adjustment ("COLA") for Social Security saves very large amounts of money. In December of 1996, The Boskin Commission reported to Congress its conclusion that the then current method of calculating the Consumer Price Index ("CPI") over stated the rate of inflation by 1.1%. This conclusion was highly controversial, but almost everyone agreed that CPI was overstated by some factor. On April 16, 1998, The Bureau of Labor Statistics announced the last in a series of reductions to the CPI. These final changes will take effect on January 1, 1999, and, together with reductions that have already been made, will total .8 of one percent. (It is hard to determine whether the Social Security Trustees took any account of these CPI reductions in their April, 1998 Report, but it seems certain that they took no account of the more recent changes.)

Small reductions in CPI have enormous effects. The Advisory Council estimated that reducing CPI by 0.5 percent, beginning in 1998, would save 0.72 percent of payroll, or about a third of the entire actuarial shortfall. Even if no changes in CPI are legislated, the long term picture is already considerably brighter than reported by the Advisory Council a year ago.

Gradually increasing the normal retirement age also results in substantial savings, even if the adjustments are relatively minor. Currently the normal retirement age is scheduled to increase very gradually beginning in the year 2000. By 2027, the normal retirement age will be 67. If the normal retirement age were to be raised by two months a year, beginning in 2000, capping at age 68 in 2017, the Advisory Council estimates that this would save 0.49 percent of payroll.

Polls show that the only Social Security reform proposal which enjoys 50 percent or more popular support is the means testing of benefits. The Concord Coalition suggested phasing out benefits for those having income over \$40,000 per year, capping the reduction at 85 percent of benefits. According to the Advisory Council, this would save 1.65 percent of payroll.

Currently Social Security benefits are free of tax for most recipients. Other annuities are 100 percent taxable after the beneficiary has recovered his or her basis (after-tax contributions) in the annuity. Taxing Social Security benefits on the same basis as other income would not be popular, but it is difficult to argue that it would not be fair.

Eliminating the wage base cap would also raise very large amounts of money, even though relatively few people would be effected. This has already been done with respect to Medicare.

Mandatory Social Security coverage of new hires will not come close to solving Social Security's problems. Even if the Advisory Council projection of 0.22 percent of

payroll is correct, it was based on the assumption that mandatory coverage would be imposed January 1, 1998. The earliest legislation is expected would be next year, and there is no way state and local governments could adjust to mandatory coverage by the year 2000, based upon legislation enacted in 1999. Many of those who have looked at the problem believe that it would take state and local governments four years to adjust to the legal, financial, and administrative problems connected with mandatory coverage. Moreover, mandatory coverage would be the subject of Tenth Amendment litigation, possibly causing more delay, and making it uncertain whether revenue from mandatory coverage would ever be realized.

In addition, there would be offsets. Some employee contributions to public pension plans are tax deductible, but all benefits are taxable (after the worker has recovered his or her basis). Employee contributions to Social Security are not tax deductible, but all benefits are tax free to most recipients. Moreover, state and local governments would have to raise taxes to pay their share of OASDI taxes (and perhaps some or all of the employees' share as well) and many of these new taxes would be deductible for federal income tax purposes.

Eventually, of course, public employees would draw out benefits on the same basis as everyone else. If mandatory coverage of new hires were to be imposed relatively soon, benefits would come do for newly covered employees would begin to come due around 2030, exactly the time when Social Security is predicted to be in its greatest crisis, at least on an actuarial basis.

Worst of all, of course, would be for Congress to cover new hires, but fail to save the tax revenues. That policy is precisely what has created the difficulties that we face today.

On the other hand, if the government does save the surpluses in the Social Security Trust, and if the economy continues to prosper, these factors, together with the CPI adjustments which have already been announced, will make it easier to face whatever is left of the problem. It would be worth while to examine these developments before taking more radical action.

Of course, Congress may decide to modify the current structure of Social Security not merely to solve the funding problem, but to provide better retirement benefits for participants. Such action (usually described as privatization) might increase costs for Social Security participants in order to provide the increase in benefits. But there is no reason why public employees should pay these costs; they are already funding their own system.

### *3. Mandatory Social Security Coverage Will Harm Existing Public Plan Participants and Retirees and This Proposal Is Not Fair.*

Some people argue that mandatory Social Security coverage should be imposed on grounds of fairness. The Advisory Council argues, at page 19 of its Report, "all Americans have an obligation to participate [in Social Security], since an effective Social Security program helps to reduce public costs for relief and assistance, which, in turn, means lower general taxes." Other people have an instinctive reaction that if Social Security is good enough for everyone else, why shouldn't public employees participate. It is also argued that, at least in percentage terms, Social Security confers a high benefit on very low paid workers, and that in the future most other wage earners will have to subsidize this benefit. (Until recently, almost all participants had a very positive return from Social Security in dollar terms.)

Public retirement plans also reduce public costs for relief and assistance in precisely the same way that Social Security achieves that effect. Employees covered by public plans are not candidates for welfare, SSI, or other forms of public assistance. Public plans provide higher dollar benefits in proportion to salary and years of service than does Social Security. Low income workers depending entirely on Social Security for their retirement income are virtually certain to need public assistance.

Moreover, whereas the Social Security funding problem has created substantial exposure to the federal government in terms of future needs for revenue, there is no exposure to the federal government, or to the taxpayers who support that government, in connection with public plans, because public plans are not insured by the Pension Benefit Guaranty Corporation.

There is some evidence that the Advisory Council was not that concerned with questions of fairness. In an April, 1997, speech before the National Conference of Public Employee Retirement Systems, Edith Fierst, a member of the Council, said of the mandatory coverage proposal, "We did it primarily because it would be good for Social Security, not because it would be good for the employees. Our interest was that if people came into Social Security and began to pay the Social Security tax, that helps the Social Security's trust fund, and they won't start to draw benefits based on those contributions for some years."

Whether or not public employees should be in Social Security because everyone else is depends to a considerable extent on why the nation is having a serious conversation about Social Security. If we were writing on a clean slate, with full knowledge of the problems Social Security faces, and the alternatives to Social Security which could provide greater retirement security for the vast majority of beneficiaries, it is highly likely that the nation would follow a model that is much closer to the public plan model, than to Social Security as it exists today. To the extent that Congress determines to establish private retirement accounts for Americans, to replace all or part of the current Social Security system, it makes no sense whatever to move millions of public employees in the opposite direction. This can only complicate transition problems, and raise the ultimate cost of moving toward a privatized system.

Public employees did not cause the current funding problems for Social Security, nor did non-covered public employees benefit during the many decades when almost every participant came out of the Social Security system a winner. Social Security surpluses have helped to disguise deficits in the general operating budget of the federal government, primarily during the last ten years, and public employees have experienced lower federal income taxes (or lower federal debt owed to third parties) or exactly the same basis as everyone else, including Social Security participants and beneficiaries, but no more so. If it is decided to repay the Social Security Trust Fund in the future out of general fund surpluses, public employees will pay their share of those surpluses through federal income taxes and other federal taxes.

Throughout most of its history, and even today, Social Security was an arrangement where everyone won. For example, low-wage single workers who turned 65 in 1960 paid life-time taxes of \$4,000, [employer and employee] and received life-time benefits of \$30,100, for a positive return of \$26,100 [in 1993 constant dollars] (Steuerle and Bakija, "Retooling Social Security for the 21st Century," *The Social Security Bulletin*, 1997, #2, at page 47, the "Bulletin Report".) High wage earners received a more positive return measured in dollars, although low-wage workers received a better return measured as a percentage of life-time taxes to benefits. But members of every group (low, average, and high earners, male and female, single and married, one-earner and two-earner couples) that turned age 65 in 1960, on average, came out big winners. High wage single men (the least favored category) received life-time benefits equal to almost four times life-time taxes. Factors such as sex (women did better than men) and marital status (married one-earner couples received life-time benefits equal to eight-and-a-half times life-time contributions) were very important in determining how good a deal you received. Social Security was not a re-distributional system from high-earner to low-earner. Everyone won; high-earners won the most in dollars; women and married couples won the most in percentage terms. (For purposes of these calculations, high-earners are assumed to receive at least the maximum wage subject to Social Security tax (\$65,400 in 1997); average-earners are assumed to receive the Social Security Administration's measure of the average national wage (\$26,700 in 1997) each year from age 21 to age 65, and low-wage earners are assumed to receive 45 percent of this amount (about \$12,000)).

This pattern continued for workers who reached age 65 in 1980. Positive returns for 1980 retirees were actually greater than those received by their 1960 counterparts measured in dollars; measured as a percentage of life-time contributions to life-time taxes, however, the 1960 cohort did much better. But every category of worker reaching age 65 in 1980 had a substantially positive rate of return.

For the most part, this pattern also continues for those who reached age 65 in 1995. For the first time, however, there are projected to be losers. Average-income and high-income single males who retire in 1995 will, on average, receive less in benefits than they and their employers paid in taxes. All other categories of workers, including high-earner categories, will receive positive rates of return, though not as high, measured either in dollars or percentages, as they would have received in the past.

For those reaching age 65 in 2010, most single male workers will have a negative rate of return (single male low-earners will essentially break even) and single women, other than low-wage single women, will also lose. Married couples are projected to have positive rates of return for this age category, with the exception of high-wage two-earner, couples, who will experience substantial losses.

For those reaching age 65 in 2030, exactly the same categories are projected to win and lose, although losses will be greater, measured in dollars, and positive rates of return will be low for most of the categories of winners.

Social Security has never been a system of income transfer from relatively rich to relatively poor, nor will it be such a system in the future. To some extent, within

members of the same generation, Social Security will become a transfer system from single to married, especially single-earner married.

Nor does Social Security pay a benefit that low-wage people can live on. The average low-earner retiring at age 65 in January 1996 would receive a monthly benefit of \$537. (Fast Facts and Figures about Social Security, The Social Security Administration: 1996, page 16) Any additional support that is necessary is paid out of the general fund, in the form of SSI benefits. Income taxes of public employees support the general fund on the basis as everyone else.

The average annual salary for a full time state or local government employee, nation wide, in October 1995, was \$33,464. (Statistical Abstract of the United States: 1997: page 326) For all full time workers in 1995, the average annual salary was \$40,367 for men, and \$26,547 for women. (Statistical Abstract, page 474) (The average of these two amounts is \$33,457.) Public employees are squarely in the mid-range of all Americans in terms of their compensation. If public employees were to be brought within the system, there is no way that they would "subsidize" the benefits for any other group.

For most public employees, their rights in their retirement plan represent a substantial portion of their life time savings. In 1989, the median American household had a net worth of approximately \$42,000, much of this tied up in the equity in their home. Forty-two thousand dollars is not a large cushion. For middle income public employees, the security provided by their public retirement plan is all that makes possible a retirement with dignity.

But it will not be possible for public plans to maintain their current benefit structure, if mandatory coverage is imposed, even for existing plan participants and existing retirees. As discussed above, page 5, Ohio STRS has estimated that mandatory coverage on a new hires basis would require the elimination of health care benefits, and would also require the reduction or elimination of cost-of-living adjustments, or normal retirement benefits, or the elimination of ancillary benefits for plan participants. (These estimates assume a relatively restrictive definition of "new hire;" If the COBRA definition were used, the situation would be much worse.) The average Ohio STRS retiree lives 25 years; three years of retirement are paid for by employee contributions; six years are paid for by employer contributions; sixteen years are paid for by earnings on investments.

Other systems report similar problems. For example, PERA of Colorado projects an end to plan improvements for current participants and retirees, and new hires would receive a combined Social Security and PERA benefit that would be slightly less than half of the current PERA benefit.

At page 20 of its report, the Advisory Council puts forth, as one argument for mandatory coverage, that a high proportion of state and local government workers will receive Social Security benefits because of non-government work which they perform, or through their spouses. A Council of Social Security experts should very well know, but fail to acknowledge, that state and local government workers do not receive any unfair advantage from remaining outside of the Social Security system for most, or part, of their career. In 1983, as part of the overall Social Security reforms enacted in that year, Congress adopted an anti-windfall rule, which has the general effect of reducing any Social Security benefit that the employee might otherwise be entitled to in accordance with a formula based on the period of time during which the employee was not covered by Social Security. This adjustment is made because Social Security is bottom weighted—that is, Social Security tends to provide relatively high benefits for workers who have relatively low career average earnings. Another rule which is applicable to non-covered government workers, known as the spousal offset rule, reduces the spousal benefit which would otherwise be payable to these workers.

#### *4. Mandatory Social Security Coverage Has the Same Adverse Effects As Do Unfunded Mandates.*

In recent years Congress has rightly been concerned about the effects on state and local governments of imposing costly federal requirements on those governments, without providing the necessary money. The Unfunded Mandate Reform Act of 1995 passed over-whelmingly in both the House and the Senate.

The cost mandatory coverage on a new hires basis would be over \$100 million in the first year for Ohio, and almost \$200 million for California. When fully phased in, California's annual cost would be over \$2 billion, and states such as Texas, Colorado, Illinois, Massachusetts, and Louisiana would face annual costs in the hundreds of millions of dollars. Even states like Washington, Florida, Georgia, Connecticut, Kentucky, Michigan, and Minnesota, which are not commonly thought of as non-Social Security states, would face costs in excess of \$100 million per year.



The burden caused by these extra costs would fall most heavily on those who can afford it least, such as large cities which have substantial low-income populations. In a March 15, 1998 article, *The Washington Post* discussed a report by the Milton S. Eisenhower Foundation. (See, "Rejuvenation of Cities: Was It Just Cosmetics?," page A3) The report concluded that "Most adults in many inner-city neighborhoods are not working in a typical week." Two-third of children fail to achieve basic reading levels. Child poverty, segregation, and imprisonment have all risen.

Buzz Bissinger, author of the recent book, "A Prayer for the City," reaches similar conclusions when he discusses the energetic reform efforts of Philadelphia Mayor Ed Rendell, which he views largely as a failure. Bissinger concludes that wide-spread improvement may be possible for New York, because immigration keeps the population up, and because that city is awash in money from Wall Street. But many other cities, like Atlanta, Cleveland, Detroit, Miami, and Newark, among others, have no such advantages, and are far less likely to be able to re-define themselves in ways that benefit the poorer neighborhoods.

On March 12, 1997, bi-partisan representatives of the National Governors' Association testified before a joint session of the House and Senate Budget Committees, urging Congress not to enact federal tax cuts which would force state or local tax hikes. Mandatory Social Security coverage would be worse, a federal tax hike which would also force state and local tax hikes.

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Chairman BUNNING. Mr. Schumacher.

**STATEMENT OF RICHARD E. SCHUMACHER, EXECUTIVE  
DIRECTOR, PUBLIC EMPLOYEES RETIREMENT SYSTEM OF  
OHIO**

Mr. SCHUMACHER. Thank you, Mr. Chairman, Members of the Subcommittee. I appreciate the opportunity to give testimony this morning.

The potential extension of mandatory Social Security coverage to all or any portion of Ohio's public employees is a serious concern to the Public Employees' Retirement System, PERS, of Ohio. PERS was established by the Ohio legislature in 1933. The retirement system is a multiemployer plan covering 3,700 public employers and 638,000 members and benefit recipients. We currently have over \$47 billion in assets.

PERS provides retirement, disability, and survivor benefits, also, health care coverage. Our program is a defined benefit plan and is prefunded through employee and employer contributions. The major source of significant revenue is investment income. At our inception, the legislature established a social contract with all of Ohio's public employees. Fiscally sound prefunding was one of the important covenants. The funds are to be available when retirement is requested. The 1994-96 Advisory Council of Social Security stated, and I quote, "In the past, efforts to deal with Social Security's financial difficulties have generally featured cutting benefits and raising tax rates on a pay-as-you-go basis. Further, all three plans favored by the Council endorse the practice of partial, advanced funding." As the baby boomer generation begins to retire, heavy pressure will be exerted on pay-as-you-go plans, and the results could be disastrous.

The major difference between a prefunded plan and a pay-as-you-go plan is investment income. Over 80 percent of the benefits paid by PERS come from investment earnings. Mandating public employee new hires into Social Security would severely affect State and local pension systems. Focusing on new hires alone creates the

illusion that no one else would be affected. That is a false assumption. All systems in Ohio would be faced over time with cutting benefits to current, active members and retirees. Boards could be faced with harmful choices to reduce or eliminate health care. The fiscal impacts on this proposal on State and local retirement plans would be significant. Costs would be shifted from the Federal Government to State and local governments. Remember, over 80 percent of our benefit disbursements are paid by investment income. The loss of contributions results in fewer funds to invest. This means less investment earnings, longer funding periods, and higher contribution rates.

Another tragic consequence is the unfunded mandate that would be imposed on State and local governments. The important legislation on unfunded mandates that came from the House Ways and Means Committee in 1995 is extremely relevant today on the issue of mandatory coverage. State and local government officials appreciated your actions then and urge that the same commitment continue today. If our contribution rate was decreased by 12.4 percent for Social Security, we would need an additional 6- to 7-percent increase in contributions to provide a comparable level of benefits. Who is going to pay the increased cost? It will be shared by workers and their employers. Workers will get less take home pay, and employer costs will increase. Taxpayers will pay more.

Since 1935, various changes have been enacted to mandate large sectors of employees into Social Security, generally, driven by the need for additional cash flow to pay benefits. Each time, the basis for the change was to, supposedly, strengthen the program. Each time, it has failed. Merely including more participants does not improve the program's long-term stability. It may for a couple of years, but as retirements increase, greater and greater resources are needed.

It is reported that the unfunded liability for Social Security is in excess of \$9 trillion. Each revision of Social Security has focused on raising additional revenue and or raising the retirement age. Perhaps, this time, it is prudent to focus on liabilities, but the legislative fix looking to increase short-term cash flow, requiring newly hired public employees to be under the Social Security Program would cause a substantial increase in long-term Social Security liabilities and in taxpayers' liabilities in the State of Ohio as well as many other States and their subdivisions.

It seems unwise to financially and administratively disrupt our plans for the purpose under consideration by this Subcommittee. Indeed, requiring newly hired public workers and their employers to participate in Social Security would constitute a tax increase on millions of Americans.

Many public plans financed by taxpayers and public workers are operating in a sound and prudent fiscal manner. Rather than imposing mandatory Social Security, our successes should be studied for ideas to use in restructuring Social Security. Thank you.

[The prepared statement follows:]

**Statement of Richard E. Schumacher, Executive Director, Public Employees Retirement System of Ohio**

The potential extension of mandatory Social Security coverage to all or any portion of Ohio's public employees is a serious concern to Public Employees Retirement System of Ohio (PERS).

PERS was established by the Ohio Legislature in 1933. Benefits were first paid January 1938. The Retirement System is a multiemployer plan covering 3,700 public employers (includes all departments of state and all levels of local government), and 638,000 members and benefit recipients. PERS provides retirement, disability and survivor benefits, and health care coverage. Our program is a defined benefit plan and is pre-funded through employee and employer contributions. The major source of significant revenue is investment income.

At our inception, the legislature established a social contract with all of Ohio's public employees. Based on that contract, steps were taken to secure future benefits. Fiscally sound pre-funding was one of the important covenants. The funds are collected over a person's working career to be available when retirement is requested.

The 1994-1996 Advisory Council of Social Security, in its 1997 Report, stated:

"In the past, efforts to deal with Social Security's financial difficulties have generally featured cutting benefits and raising tax rates on a pay-as-you-go basis...."

"Historically, Social Security has been financed on a current pay-as-you-go basis.... All three plans favored by the Council endorse the practice of partial advance funding...."

As the baby boomer generation begins to retire, heavy pressure will be exerted on pay-as-you-go plans and the result could be disastrous. All plans have already experienced a large drop in the ratio of active workers to retirees to fund retirement benefits.

The major difference between a pre-funded plan and a pay-as-you-go plan is investment income. Over 80% of the benefits paid by PERS come from investment earnings. Currently our system collects about 22% of covered payroll in employee and employer contributions.

Mandating public employee new hires into Social Security would severely affect state and local pension plans. Focusing on new hires alone, creates the illusion that no one else would be affected; that is a false assumption. All systems in Ohio would be faced over time with cutting benefits to current active members and retirees. Boards could be faced with harmful choices to reduce or eliminate health care. The fiscal impact of this proposal on state and local retirement plans would be significant; costs would be shifted from the federal government to state and local governments. Reduction of our contributions would severely restrict investment income sources. Remember, over 80% of our benefit disbursements are paid by investment income. The loss of contributions results in fewer funds to invest. This means less investment earnings, longer funding periods, and higher contribution rates.

Another tragic consequence is the unfunded mandate that would be imposed on state and local governments. The important legislation on unfunded mandates that came from the House Ways & Means Committee in 1995 is extremely relevant today on the issue of mandatory coverage. State and local government officials appreciated your actions then and urge that the same commitment continue today.

If our contribution rate was decreased by the 12.4% to fund Social Security, we would need an additional 6-7% increase of covered payroll to provide comparable benefits. A survey indicates a higher average total cost for Social Security integrated plans at 26% versus non Social Security covered plans of 22%. Who is going to pay for the increased cost? It will be shared by workers and their employers. Workers will get less take home pay and employers' costs will increase—taxpayers will pay more.

Since 1935, various changes have been enacted to mandate large sectors of employees into Social Security, generally driven by the need for additional cash flow to pay benefits. Each time the basis for change was to supposedly strengthen the program. Each time it has failed. Merely including more participants does not improve the program's long term stability. It may for a couple of years, but as retirements increase, greater and greater resources are needed.

It is reported that the unfunded liability for Social Security is in excess of \$9 trillion. Each revision of Social Security has focused on raising additional revenue and/or raising the retirement age. Perhaps this time it is prudent to focus on the liabilities. The 638,000 members and beneficiaries of our system do not cause liabilities for Social Security. But the legislative fix—looking to increase the short term cash flow—requiring newly hired public employees to be in the Social Security program—would cause a substantial increase in long term Social Security liabilities and in

taxpayer liabilities in the state of Ohio as well as many other states and their subdivisions.

It seems unwise to financially and administratively disrupt these plans for the purpose under consideration by the Subcommittee. Indeed, requiring newly hired public workers and their employers to participate in Social Security would constitute a tax increase on millions of Americans. Many public plans financed by taxpayers and public workers are operating in a sound and prudent fiscal manner. Rather than imposing mandatory Social Security—a new tax on America—our successes should be studied for ideas to use in restructuring Social Security.

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Chairman BUNNING. Sergeant Pfeifer.

**STATEMENT OF MARTY PFEIFER, SERGEANT, WASHINGTON METROPOLITAN POLICE DEPARTMENT; AND DISTRICT OF COLUMBIA TRUSTEE, NATIONAL FRATERNAL ORDER OF POLICE**

Mr. PFEIFER. Good morning, Mr. Chairman, distinguished Members of the House Subcommittee on Social Security. My name is Sergeant Marty Pfeifer, and I'm a 26-year veteran with the Metropolitan Police Department in Washington, DC and currently serve as the elected Trustee from the District of Columbia on the National Board of the Fraternal Order of Police which is the largest organization of law enforcement professionals in the Nation representing over 272,000 members.

In addition, in 1995, I served as chairman of the District of Columbia Retirement Board which provides retirement benefits for police officers, fire fighters, teachers, and judges in the District of Columbia, none of whom participate in Social Security. Since 1996, I have chaired the Investment Committee of the board which now manages approximately \$5 billion in assets.

I am here this morning to discuss fairness; fairness to those officers, public safety officials, and other public employees who have chosen not to contribute to Social Security. We understand there are proposals being considered that would require the inclusion of all public sector employees in the Social Security system.

The Fraternal Order of Police vehemently opposes any Social Security reform measures that include mandatory Social Security participation. Employees in nine Social Security covered jurisdictions represent a sizeable portion of State and local government work forces. According to OPPOSE, over 3.9 million full-time employees are affected. Social Security coverage varies considerably, of course, by employee group, but it should be noted that according to the Public Pension Coordinating Council, 76 percent of public safety personnel do not participate in Social Security.

If the Federal Government imposes mandatory Social Security participation, even if only restricted to new hires, it not only comprises severely the financial solvency of existing pension and retirement plans, the cost to State, localities, and the individual employees would be immense. Both the employee and his or her employer would each be required to pay an additional 6.2 percent of payroll into Social Security. This amount would be in addition to the contribution already paid by the employer and the employee into the State or local retirement system.

I cannot overestimate the damage that would be done to State and local governments and families of the employees if the Federal Government forces them to pay a new tax of 12.4 percent. Collected data shows that the first year cost to employers, local and State governments, of covering newly hired employees would be over \$771 million. The newly hired employees would be responsible for an equal amount making the cost in the first year of over \$1.5 billion. The total annual cost to employers for covering employees not currently covered under Social Security would be about \$8.5 billion. When the employee share is counted, that amount rises to over \$17 billion per year.

For example, Mr. Chairman, of the over 240,000 State and local employees in the State of Kentucky, more than 61,000, many of whom are law enforcement officers do not currently participate in Social Security. The annual cost of mandating participation is approximately \$80.9 million a year.

Federally mandated participation in Social Security is not a minor issue. Such a mandate would adversely affect millions of employees and impose billions of dollars in additional cost to State and local governments who are trying to stretch every dollar. Many retirement and pension plans for public sector employees have been specifically designed and refined on the assumption that local governments would not be required to participate in Social Security. This was a reasonable assumption since local governments have never been required to pay into the system adopted in 1935 for those who chose to participate.

An important consideration for law enforcement and other public safety officers is a much earlier retirement age than other more typical government employees. Local and State retirement plans take this early retirement into consideration; Social Security does not. As this Subcommittee is aware, the Advisory Council on Social Security recommended that extended to all newly hired State and local government employees as a way to raise 10 percent of the money needed to rebalance the program. The Council's report failed to address the impact that mandatory participation would have on the employers and the employees at the State and local levels of government.

The Fraternal Order of Police understands that reforming Social Security is necessary and certain steps need to be taken if we are to avoid the expected shortfall in 2030. Sometimes these proposals sound good on the surface but after careful consideration are revealed to be unsound policies with damaging consequences. We believe that mandating the inclusion of all public sector employees into the Social Security system falls into this category.

This is about fairness, Mr. Chairman. It is unfair to change the rules 63 years later because the Federal Government is looking for an easy way to fund Social Security without making hard choices. The State and local governments who chose not to participate in Social Security did not create this problem nor did the nearly 4 million employees who do not pay into the system, but all of them would be paying a hefty price for their previous decision to create their own retirement plans. Destroying the retirement programs of these hard working Americans and raiding the budgets of State

and local governments should not be a part of the Federal Governments solution.

Mr. Chairman, I want to thank you and the Members of the Subcommittee for the opportunity to appear here today. I'd be pleased to answer any questions.

[The prepared statement follows:]

**Statement of Marty Pfeifer, Sergeant, Washington Metropolitan Police Department; and District of Columbia Trustee, National Fraternal Order of Police**

Good morning, Mr. Chairman and distinguished Members of the House Subcommittee on Social Security. My name is Sergeant Marty Pfeifer and I am a 26 year veteran with the Washington Metropolitan Police Department and currently serve as the elected Trustee from the District of Columbia on the National Board of the Fraternal Order of Police, which is the largest organization of law enforcement professionals in the nation, representing over 272,000 officers.

In addition, in 1995 I served as Chairman of the District of Columbia Retirement Board, which provides retirement benefits for law enforcement officers, teachers, fire fighters and judges in the District of Columbia—none of whom participate in the Social Security system. Since 1996, I have chaired the Investment Committee of that Board, managing approximately \$5 billion in assets.

I am here this morning to discuss fairness. Fairness to those officers, public safety officials and other public employees who have chosen not to contribute into the Social Security system. We understand that there are proposals being considered which would require the inclusion of all public sector employees in the Social Security system.

The Fraternal Order of Police vehemently opposes any Social Security reform measures that include mandatory Social Security participation.

Employees in non-Social Security-covered jurisdictions represent a sizable portion of the State and local government workforce. According to OPPOSE, an organization opposed to mandatory Social Security coverage with which the F.O.P. works on this issue, over 3.9 million full-time employees are affected.

Social Security coverage varies considerably, of course, by employee group, but it should be noted that, according to the Public Pension Coordinating Council (PPCC), seventy-six percent (76%) of public safety personnel do not participate in Social Security.

If the Federal government imposes mandatory Social Security participation, even if only restricted to new hires, it not only compromises severely the financial solvency of extent pension and retirement plans, the cost to States, localities, and the individual employees would be immense. Both the employer and his or her employer would each be required to pay 6.2% of payroll into the Social Security trust fund. This amount would be in addition to the contribution already paid by the employer and the employee into the State or local retirement system.

I cannot overestimate the damage that would be done to State and local governments and the families of the employees if the Federal government forces them to pay a new tax of 12.4%.

Collected data shows that the first year cost to employers—local and State governments—of covering newly hired employees would be over \$771 million. The newly hired employees would be responsible for an equal amount, making the cost of the first year coverage over \$1.5 billion. The total annual cost to employers for covering employees not currently covered would be \$8.5 billion. When the employees' share is counted, that amount rises to over \$17 billion per year.

For example, Mr. Chairman, of the over 240,000 State and local employees in the State of Kentucky, more than 61,000—many of whom are law enforcement officers—do not currently participate in Social Security. The annual cost of mandating participation is approximately \$80.9 million a year.

Federally mandated participation in Social Security is not a minor issue. Such a mandate would adversely affect millions of employees and impose billions of dollars in additional costs to the State and local governments who are trying to stretch every needed dollar at the local level.

Many retirement and pension plans for the public sector employee have been specifically designed and refined on the assumption that local governments would not be required to participate in the Social Security system. This was a reasonable assumption since local governments have never been required to pay into the system—adopted in 1935 for those who chose to participate. An important consideration for law enforcement and other public safety officers is an much earlier retire-

ment age than other, more typical, government employees. Local and State retirement plans take this early retirement into consideration. Social Security does not. In the event mandatory participation is imposed, how are public safety officers supposed to live between the time that they retire and the age at which they qualify to collect Social Security?

As this Subcommittee is doubtlessly aware, the Advisory Council on Social Security recommended that Social Security be extended to all newly hired State and local government employees as a way to raise ten percent (10%) of the money needed to rebalance the program. The Council's report failed to address the impact that mandatory participation would have on employers and employees at the State and local level of government.

The Fraternal Order of Police understands that reforms in the Social Security system are necessary and that certain steps need to be taken if we are to avoid the expected budget shortfall in 2030. Sometimes, proposals sound good on the surface, but after examination are revealed to be unsound policy with damaging consequences. We believe that mandating the inclusion of all public sector employees falls into this category.

This is about fairness, Mr. Chairman. It is unfair to change the rules sixty-three years later because the Federal government is looking for an easy way to earn revenue and "save" Social Security without making hard choices. The State and local governments who chose not to participate in Social Security did not create this problem, nor did the nearly four million employees who do not pay into the system. But all of them would be paying a hefty price for their previous decision to create their own retirement plans. Destroying the retirement programs of these hard-working Americans and looting the budgets of State and local governments should not be part of the Federal government's solution.

Mr. Chairman, I want to thank you and the members of this distinguished Subcommittee for the opportunity to appear before you today. I would be pleased to answer any questions.

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Chairman BUNNING. Thank you.  
Mr. Lussier.

**STATEMENT OF THOMAS R. LUSSIER, EXECUTIVE DIRECTOR,  
MASSACHUSETTS TEACHERS' RETIREMENT BOARD**

Mr. LUSSIER. Mr. Chairman, Members of the Subcommittee, my name is Tom Lussier. I'm the executive director of the Massachusetts Teachers' Retirement System. We administer retirement, survivor, and disability benefits for nearly 110,000 active, inactive, and retired public school teachers and administrators. We enrolled our first member on July 1, 1914.

It is our opinion that expanding Social Security taxes will result in higher costs to all Massachusetts taxpayers; reduced benefits for all future Massachusetts teachers; unintended reductions in critical public services, and the destruction of our current retirement systems. Worse, it is our belief that this enormous price, paid by our taxpayers and public servants, will produce no appreciable, positive result on behalf of the Social Security Program.

The problems that bring us together for this hearing are not dissimilar from those that have been successfully confronted by public plans throughout the country. In 1987, Massachusetts ultimately faced the reality that a pay-as-you-go financing program was irresponsible and threatened the stability of our State budget and the retirement security of our dedicated public employees. Over a period of time, we have adopted and funded actuarially sound funding schedules, and we've repealed regressive legalist restrictions on the investment of system assets. As a result, the MTRS has seen its original 40-year funding schedule reduced by 10 years. Our sys-

tem which in 1987 was less than 40 percent funded, by some estimates, is currently more than 85-percent funded.

In our view, it is totally unreasonable to assume that Massachusetts or any other State which finds itself in a similar situation will be able to maintain a comprehensive benefit program and absorb the additional employer costs resulting from forced Social Security coverage. The actuary for the Massachusetts Public Employer Retirement Administration Commission has reported that the Social Security benefit is 43 to 75 percent below the Massachusetts superannuation retirement benefit depending on salary. Normal cost payments by employers in Massachusetts are currently trending downward. In fact, for employees hired after July 1, 1996, these costs range between 2 and 4 percent of salary. The present Social Security employer rate is 6.2 percent. Thus, for new employees only, Massachusetts government employers would be required to make an additional payment under Social Security of between 2.2 and 4.2 percent of payroll just to pay their Social Security tax.

Inevitably, the passage of mandatory Social Security coverage will result in the repeal of current retirement benefits. Although there is a temptation to assume that a supplemental retirement program would be developed to bridge the gap between the level of Social Security benefits and those currently provided by our system, it is pure speculation as to what form such a program might take.

Some have suggested that imposing mandatory Social Security coverage on all State and local government employees is a simple matter of fairness. Since fairness is a difficult quality to evaluate, consider these questions: Massachusetts has provided retirement benefits for its public school teachers since 1914. Is it fair to undermine that commitment in order to ever so slightly improve the short-term cash flow of a pay-as-you-go Social Security system that will provide our public employees reduced benefits at higher costs? The Massachusetts legislature has crafted a public retirement program that responds to the unique characteristics of vastly different jobs, risks, and responsibilities. Is it fair to force the abandonment of such a program in order to fund a less secure one-size-fits-all program? The implementation of mandatory Social Security will increase the cost of providing retirement benefits for the Commonwealth and most of its cities and towns. Is it fair for the Congress to impose such a tax on our State and municipalities? The Unfunded Mandate Reform Act of 1995 received overwhelming support throughout the Congress. Is it fair to be against unfunded Federal mandates except for this one?

In closing, please accept my most sincere best wishes in your endeavor to strengthen and prudently fund the Social Security Program. Over the years, many of us who have opposed mandatory Social Security have been incorrectly seen as anti-Social Security. The Social Security Program is an American treasure, and it must be preserved and strengthened. For nearly 20 years, my mother's monthly Social Security check was her most significant means of support. Her Social Security benefit allowed her as it does millions of other Americans the opportunity to live independently and with dignity. We owe it to her and to countless people like her to preserve and to protect the Social Security system. However, I would



respectfully suggest to you that it would be wrong to honor that commitment by causing Massachusetts and other States to break their commitments made to their members and to their public retirement systems. Thank you, Mr. Chairman.

[The prepared statement follows:]

**Statement of Thomas R. Lussier, Executive Director, Massachusetts Teachers' Retirement Board**

My name is Thomas R. Lussier. I am the Executive Director of the Massachusetts Teachers' Retirement Board (MTRB), a position that I have held since November of 1984. I served as the First Deputy Commissioner of the Massachusetts Division of Public Employee Retirement Administration during 1983 and 1984 after having been elected to four terms in the Massachusetts House of Representatives. I served as a member of the Massachusetts Retirement Law Commission from 1984 through 1987 and am currently an elected member of the Executive Committee of the National Council on Teacher Retirement.

The MTRB administers retirement, survivor and disability benefits for nearly 110,000 active, inactive and retired public school teachers and administrators who comprise the membership of the Massachusetts Teachers' Retirement System (MTRS). The MTRS, originally known as the Massachusetts Teachers' Retirement Association, was established by the Massachusetts General Court in 1914. Our first member was enrolled on July 1, 1914. The MTRS is one of the 106 contributory retirement systems that serve the public employees of the Commonwealth of Massachusetts. Collectively, the Massachusetts public retirement community represents nearly half a million employees, retirees and beneficiaries who remain outside of the Social Security System. The assets of these systems exceed \$30 billion.

On behalf of the members of the MTRB and our membership, let me first fully endorse the very comprehensive testimony that has been submitted by Robert J. Scott on behalf of The Coalition to Preserve Retirement Security (CPRS). We are active members of the CPRS and are proud to be part of such a positive effort on behalf of millions of public employees and their beneficiaries. To supplement the message of the CPRS, I want to specifically express our very serious concerns with regard to the negative impact that will most certainly result should Congress opt to mandate Social Security coverage on Massachusetts public school teachers and administrators. In general, our concerns could easily be echoed by the administrators and trustees of each of the Commonwealth's other 105 retirement systems on behalf of their active and retired members.

It is our opinion, that expanding Social Security taxes and coverage to Massachusetts teachers and to all other public employees will result in higher costs to all Massachusetts taxpayers, reduced benefits for all future Massachusetts teachers and other public employees, unintended reductions in critical public services such as education and public safety, and the destruction of our retirement systems as we currently know them. Worse, it is our belief that this enormous price, paid by our taxpayers and public servants, will produce no appreciable positive result on behalf of the Social Security program. In fact, the long-term liabilities associated with expanding Social Security coverage to all State and local government employees will inevitably far exceed the short-term gains that can appear to make this alternative attractive.

**BRIEF BACKGROUND**

The Social Security program was established in 1935, 21 years after the first teacher was enrolled in the MTRS. The program covered all private sector employees and specifically excluded state and local government employees. Public employees not covered by a public retirement system were allowed voluntary participation in the Social Security program in 1950; those covered by a public retirement system were allowed voluntary participation in the program in 1954. Participating state and local governmental units could also withdraw from the program.

Since 1983, the Social Security Act has been amended to preclude the withdrawal of state and local governmental units; to require that all public employees hired after March 31, 1986 be covered by Medicare health insurance, with matching employer and employee contributions; to require as of 1991 that all public employees not covered by a state or local retirement plan be covered by Social Security or another plan which provides comparable retirement benefits; and to implement anti-windfall provisions to ensure that public employees who also had employment that was covered by Social Security did not receive excess credit for Social Security purposes.

Today, approximately five million Americans are outside of the Social Security system because they are covered by a public retirement plan. Additionally, there are millions of public retirees who rely on the financial strength and continuity of public plans for their retirement income and security.

THE SUCCESS OF PUBLIC RETIREMENT SYSTEMS SHOULD SERVE AS A MODEL FOR  
SOCIAL SECURITY REFORMS.

The problems which bring us together for this hearing are not dissimilar from those that have been successfully confronted by public plans throughout the country. In 1976, a special Massachusetts study found:

"Under the present pay-as-you-go arrangement, the future costs of Massachusetts pension benefits are scheduled to increase dramatically from 12.1 percent of state-local employee payrolls in fiscal year 1978 to 31.9 percent in fiscal 1993.<sup>1</sup>

In 1977, one of the first public hearings that I participated in as a young state legislator concerned the relative merits of abandoning a "Pay-As-You-Go" financing program for an actuarially sound funding program. At the time, numerous groups argued that future funding was unnecessary and that valuable state and local tax dollars could be better spent on far more immediate needs. In fact, the National Retired Teachers Association published a legislative alert which reported that "it would seriously damage the economy of the Commonwealth to drain off hundreds of millions of dollars for funding. We believe that the interests of present public retirees, with an average pension of \$4,500 being eroded by inflation, take precedence over some hypothetical retiree of the 21st century."<sup>2</sup>

As late as June of 1985, the Massachusetts Senate Committee on Ways and Means reported:

"It is irresponsible for a state or individual to ignore the fiscal implications of ballooning payments that must be made... Since FY1975, the state's appropriation for pension costs (including both state and teachers' pensions) have increased by 163.2 percent, which is an average increase of about 10.4 percent per year, compounded... pensions have been growing about 10 percent faster than the entire state budget."<sup>3</sup>

In 1987, Massachusetts ultimately faced the reality that a "Pay-As-You-Go" financing program was fiscally irresponsible and threatened the retirement security of all of the Commonwealth's dedicated public employees. Over a period of time we have adopted and funded actuarially sound funding schedules; we have repealed regressive "Legal List" restrictions on the investment of system assets; we have repealed an arbitrary cap on system benefits; and we have diligently monitored the potential for abuse, especially in the area of disability retirement benefits.

As a result, the MTRS has seen its original 40 year funding schedule reduced by 10 years; our system, which in 1987 was less than 40% funded, by some estimates is currently more than 85% funded. Other Massachusetts systems have totally erased their unfunded actuarial liability. We have seen modest improvements in benefits; greater opportunities for portability; and, as we speak, our Legislature is considering legislation to provide teachers with an enhanced benefit based on a formula that more properly accounts for years of dedicated service.

In a recent report prepared for the U. S. General Accounting Office, the Massachusetts Public Employee Retirement Administration Commission wrote:

"The Massachusetts experience represents a transition from 'pay as you go' funding to actuarially sound financing over a relatively short period. Present retirees and employees, as well as future employees, can be confident that a sound pension system will exist guaranteeing their hard-earned benefits. Rather than jeopardizing those benefits through forced Social Security, the federal government should look to the Commonwealth as an example..."

MASSACHUSETTS OFFERS ITS TEACHERS AND OTHER PUBLIC EMPLOYEES A SOUND RETIREMENT SYSTEM; MANDATORY SOCIAL SECURITY COVERAGE WILL RESULT IN HIGHER COSTS TO MASSACHUSETTS TAXPAYERS, WILL REDUCE BENEFITS FOR ALL FUTURE TEACHERS AND OTHER PUBLIC EMPLOYEES AND WILL RESULT IN UNINTENDED REDUCTIONS IN CRITICAL PUBLIC SERVICES.

The Massachusetts contributory retirement law (Mass. Gen. Laws, Chap. 32), which sets forth the benefits provided by each of the Commonwealth's 106 retirement systems, guarantees a sound retirement program for all Massachusetts public

<sup>1</sup> Report of the Funding Advisory Committee and the Retirement Law Commission to the Governor and General Court of Massachusetts, October 1976.

<sup>2</sup> Massachusetts Legislative News, NRTA/AARP Newsletter, January 6, 1977.

<sup>3</sup> Massachusetts Senate Committee on Ways and Means, Fiscal Year 1986 Budget Recommendations, June, 1985.

employees. The Social Security Advisory Council implies that public employees need Social Security benefits in order to offset deficiencies in public retirement plans. The facts don't support such a view.

According to a recent analysis completed by the actuary for the Massachusetts Public Employee Retirement Administration Commission, the Social Security benefit is 43-75% below the Massachusetts superannuation retirement benefit depending on salary. The Commission has concluded that "...replacing the Massachusetts benefit structure with the Social Security benefit structure substantially diminishes the purchasing power of our retirees." A closer look at the full program clearly supports such a proposition:

- Massachusetts pension benefits are guaranteed. The Massachusetts retirement law establishes a contract with each member that prevents the reduction of retirement benefits. In a 1974 advisory opinion, the Massachusetts Supreme Judicial Court stated: "...the 'contract' is formed when a person becomes a member by entering the employment, and he is entitled to have the level of rights and benefits then in force preserved in substance in his favor without modification downwards. ...When we speak of the level of rights and benefits protected by 25(5) we mean the practical effect of the whole complex of provisions..."<sup>4</sup>

- A Massachusetts retirement allowance is not reduced for post-retirement income from any source other than a Massachusetts governmental unit.

- Massachusetts provides both job related and non-job related disability benefits for members. A Massachusetts public employee receives 72% of current salary plus an annuity in the case of a job related illness or injury. For 1997, the average MTRS job related disability benefit was \$32,000; the average non-job related disability benefit was \$14,000 annually.

- The Massachusetts retirement law provides pre-retirement survivor benefits, pre- and post-retirement accidental death benefits, and each retiree has the option of providing a survivor benefit at the time of retirement. In certain instances, additional survivor benefits are available to minor children until age 22 if the child is a full-time student.

- Although they could be better, Massachusetts generally provides cost-of-living adjustments for its retirees and survivors. A recently enacted amendment provides for an annual cost-of-living adjustment equal to the CPI or 3% whichever is lower, payable on the first \$12,000 of a member's benefit. For teachers, the Massachusetts Legislature is currently considering establishing a minimum pension benefit for all teachers who retired with a minimum of 25 years of service. In a 1997 report entitled, "Retirement Benefits for the 21st Century: An Actuarial Appraisal of Retirement Alternatives" the MTRB called upon the Legislature to enact a purchasing power protection plan in order to guarantee the long-term financial security of every Massachusetts retired teacher. As we get closer to attaining our goal of full funding, post-retirement benefit protection will only get better.

- Since all Massachusetts public retirement systems are governed by a common law, retirement benefits are totally portable within the Commonwealth. In addition, since the MTRS allows relatively inexpensive purchases of service credit for out-of-state teaching, for certain non-public school teaching service, and for military service, our members enjoy the benefits of a highly portable system. Should the Congress pass the recently introduced Retirement Account Portability Act of 1998, important barriers to portability between private and public plans will be removed.

- Massachusetts retirement benefits, as is the case in virtually all public retirement plans, have been designed to meet the unique needs of our membership. Although this is particularly true for public safety employees, Massachusetts has also provided better benefits at lower retirement ages for individuals who are engaged in certain hazardous or high risk non-public safety careers. The Massachusetts Legislature is currently considering providing enhanced benefits to teachers who have served 25 years or more. In the context of education reform, many have suggested that it is in the best interest of our children to allow teachers to retire before they suffer the burnout that frequently comes at the end of a 35 or 40 year career.

In our view, it is totally unreasonable to assume that Massachusetts, or any other State which finds itself in a similar situation, will be able to maintain such a comprehensive benefit program and absorb the additional employer cost resulting from forced Social Security coverage. Additionally, Massachusetts employees, who currently make contributions ranging from 5 to 12% depending on their membership date and group classification, can ill afford to pay an additional 6.2% for Social Security coverage.

<sup>4</sup> Opinion of the Justices, 364 Mass. 847 (1974-74) Opinion of the Justices to the House of Representatives.

In the report prepared for the U. S. General Accounting Office, the Massachusetts Public Employee Retirement Administration Commission wrote:

"Normal cost payments by employers in Massachusetts are trending downward... Ultimately, for employees hired after 7/1/96, these costs would range between 2% and 4% of salary. The present Social Security employer rate is 6.2%. Thus, for new employees only, Massachusetts' governmental employers would be required to make an additional payment under Social Security of between 2.2% and 4.2% of payroll. Consequently, between \$210 and \$410 million would be required to meet these additional costs."

Inevitably, the passage of mandatory Social Security coverage will result in the repeal of our current retirement benefits for all future Massachusetts teachers and other public employees. Although there is a temptation to assume that a supplemental retirement program would be developed to bridge the gap between the level of Social Security benefits and those currently provided by our system, it is pure speculation as to what form such a program might take.

To illustrate the severity of our concerns, please consider the following summaries of three possible outcomes:

Option 1. Since our anticipated employer normal cost contribution for new members is currently less than the Social Security tax, it is fair to assume that any supplemental program will be designed as a defined contribution plan with no employer contribution. Such a program would leave future Massachusetts teachers and public employees with no disability protection, a significantly higher retirement age, and the potential for dramatically lower retirement income.

Option 2. Since the 106 Massachusetts public retirement systems are governed by one law, there is a tremendous amount of equality across the broad spectrum of Massachusetts governmental units with regard to retirement benefits. All employees currently enjoy the total portability of benefits amongst our numerous systems. Let us assume that the Legislature will opt to allow each governmental unit to respond to mandatory Social Security coverage in its own way. Portability, one of the goals of the proponents of mandatory coverage, will be destroyed and we will have a disjointed system of the "haves" and the "have-nots." Who will have more success recruiting the best public servants—the affluent community that offers a rich supplemental retirement program or the older urban community that is forced to choose between police salaries and police retirement benefits?

Option 3. Teacher retirement costs are currently the responsibility of state government. Let's assume that the Commonwealth, faced with the obligation to continue to fund the normal cost for current members of the MTRS as well as the system's actuarial unfunded liability, establishes a supplemental program for all Massachusetts teachers. Is it possible that the Legislature would fund any employer contribution to the supplemental program and absorb the 6.2% Social Security tax? It is our belief that the Legislature would opt to do neither. Future teachers would be left with a defined contribution plan with no employer contribution from the state and every local government would be faced with a totally new obligation equal to 6.2% of their teacher payroll. Mandatory Social Security coverage will then have resulted in the unintentional reduction of critical local services and/or will result in a greater tax burden at the local level.

APPLYING MANDATORY SOCIAL SECURITY COVERAGE TO NEWLY HIRED TEACHERS AND OTHER PUBLIC EMPLOYEES DOES NOT ADVANCE THE CAUSE OF FAIRNESS; MANDATORY COVERAGE IMPOSES A SIGNIFICANT UNFUNDED MANDATE.

Some have suggested that imposing mandatory Social Security coverage on all State and local government employees is a simple matter of fairness. Arguing that all Americans have an obligation to financially support the Social Security system, proponents of mandatory Social Security believe that everyone should pay his or her fair share.

First, let me suggest that all Americans, including those who are currently exempt from mandatory participation, contribute to the Social Security system. As American consumers we all participate in the economic activity that allows private employers to pay Social Security taxes on behalf of their employees. In addition, countless public employees, including myself, have contributed to the Social Security system. Notwithstanding those contributions, many of us who choose public service as our primary career, may never qualify for one dollar of Social Security benefits.

Secondly, fairness is a difficult quality to evaluate. Consider these questions:

Massachusetts has provided retirement benefits for its public school teachers since 1914. For 21 years before the Social Security system even existed, Massachusetts was responsibly fulfilling its obligation to public school teachers. For nearly four generations, Massachusetts taxpayers and our members have invested in the

future of our retirement program. Is it fair to undermine that commitment in order to ever so slightly improve the short-term cash flow of a pay-as-you-go Social Security system that will provide our public employees reduced benefits at higher costs?

The Massachusetts Legislature has crafted, and continues to enhance, a public retirement program for Massachusetts public employees that responds to the unique characteristics of vastly different job risks and responsibilities. Is it fair to force the abandonment of such a program in order to fund a less secure, "one size fits all" program?

The implementation of mandatory Social Security will increase the cost of providing retirement benefits for the Commonwealth and most of our cities and towns. The increased cost will result in higher state and local tax burdens, significantly reduced retirement protection, critical reductions in essential public services or some combination of all of the above. Is it fair for the Congress to impose such a tax on our State, our cities and our towns? To force lesser benefits on dedicated public employees? To unintentionally reduce essential local services?

The Unfunded Mandate Reform Act of 1995 received over-whelming support throughout the Congress. Congress was properly concerned about passing the cost of expensive federal mandates onto State and local governments. Is it fair to be against unfunded federal mandates... except for this one?

It has also been suggested that current members of our public retirement systems will not be effected by imposing mandatory Social Security coverage on new employees. Our experience causes us to be concerned about this suggestion as well.

For example: A 43 year old teacher in Springfield, Massachusetts, with 18 years of service in the MTRS, seeks and receives a promotional opportunity as a vice principal in the Hartford, Connecticut school system. Since she's a vested member of the MTRS, she leaves her funds on deposit and begins her commute to Hartford. After five years of experience in Connecticut, she applies for and receives a principalship back in Massachusetts. She returns home and works until her ultimate retirement.

Today, this teacher would take a refund of her contributions from the Connecticut Teachers' Retirement System, purchase her five years of out-of-state service in the MTRS and ultimately retire with essentially a career of uninterrupted creditable service. Were mandatory Social Security coverage to be applied in this instance, how would she be effected? As a new employee in Connecticut, she would have contributed to Social Security. When she subsequently returns to Massachusetts, what is she? If she's deemed to be exempt from Social Security because she's a vested member of the MTRS, will her five years of Social Security contributions in Connecticut ever benefit her? If she's deemed to be a new Massachusetts employee and therefore mandated into Social Security, will she be able to once again become active in the MTRS? Is it possible that she and her employer could be forced to fund current MTRS and Social Security contributions? Most importantly, when she ultimately retires what level of benefits will she actually be entitled to? Will the offset and anti-windfall provisions of Social Security negatively impact her ability to combine her public pension with Social Security?

This is one current member who will undoubtedly be effected by the adoption of mandatory Social Security. Let us not forget that there could be millions like her throughout America.

#### CONCLUSION

In closing, please accept my most sincere best wishes in your endeavor to strengthen and prudently fund the Social Security program. Over the years, many of us who have opposed mandatory universal Social Security coverage have been seen as anti-Social Security. At times, some have opted to tear down the system as a justification for continuing to exclude public employees. In my view, such a course is wrong. The Social Security program is an American treasure and it must be preserved and strengthened.

My Mother died last August at the age of 83. For nearly 20 years, her monthly Social Security check was her most significant means of support. A Social Security benefit allowed her, as it does millions of other Americans, the opportunity to live independently and with dignity. We all owe it to countless people just like her to preserve and protect the Social Security system. However, I would respectfully suggest to you that we would be wrong to honor that commitment by causing Massachusetts and other States to break the commitments made to the members of their public retirement systems.

Thank you for the opportunity to participate in today's hearing.

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Chairman BUNNING. Mr. Pyne.

**STATEMENT OF GEORGE PYNE, EXECUTIVE OFFICER, PUBLIC  
EMPLOYEES' RETIREMENT SYSTEM OF NEVADA**

Mr. PYNE. Thank you, Mr. Chairman. Mr. Chairman, Members of the Subcommittee, my name is George Pyne. I am the executive officer of the Public Employees' Retirement System of Nevada. By way of background, nearly 100,000 people within the State of Nevada are members or recipients of benefits from the Public Employees' Retirement System. In a State with under 2 million residents, we estimate our retirement system has some financial impact on 1 out of every 5 Nevadans.

Mr. Chairman, I have yet to talk to a member of our system who does not have serious reservations about the cost impact and threat to retirement security this proposal brings to thousands of current and future members of our PERS, Public Employees' Retirement System. The numbers speak for themselves.

Consider that Nevada PERS already provides adequate replacement income for career employees at a cost of only 18.45 percent of payroll. Should we be forced to overlay the cost of Social Security on our current plan structure, it is estimated Nevada employers and new hires share in the first-year cost of \$27 million for mandatory coverage. This increases to \$157 million in the 5th year. Given that our present member payroll is \$2.3 billion this represents a significant increase in the amount targeted for payment of retirement benefits. Even if Social Security were not a direct overlay on our current benefit structure but rather combined with reduced PERS benefits, the costs are prohibitive. For regular members of our plan the contribution rate needed to maintain current benefit levels when combined with Social Security is estimated to go from 18.45 percent of payroll to 27.1 percent. In our opinion, this shows the relative inefficiency of the pay-as-you-go funding structure of Social Security.

Continuing the scenario of maintaining level benefits at an increased cost, let's further explore what this means to the average Nevada PERS member: The teacher who teaches our children; the police officer that protects our neighborhoods. New hires would be burdened with a higher cost for the same benefits as their fellow employees. They must also suffer the potential consequences of the additional cost to their employer who will face difficult decisions about revenues to fund the added tax. Does the employer raise taxes to cover the cost or, perhaps, cut the very public services the employer is in the business of providing or fail to give cost-of-living adjustments to employees? We respectfully believe that in Nevada, employers would not seek to widen their revenue base by raising taxes, so the alternatives would be service reductions or no cost-of-living adjustments.

Mr. Chairman, the impact of a pay reduction is significant but also must be viewed as merely the first hit on our members' income. As employers seek to fund their half of the added cost, other benefits that aren't guaranteed such as health care may need to be reduced. This would impose a serious strain on the economic stabil-

ity of the member and upon his standard of living, and I must emphasize, for no additional benefits.

The alternative of cutting services to fund benefits is also not likely as Nevada is one of the fastest growing States in the nation and as more people come into our State, more public services are required, not less. From a timing perspective, this unfunded mandate could not come at a worse time. As government grows, so too grows the cost of government, and it is clear that in Nevada workers will bear the brunt of the weight of funding to bring some form of Social Security to our retirement system.

We also must be mindful that significant differences exist in the dates of retirement eligibility and other plan features for PERS and Social Security and because changes in Social Security are beyond the control of the State of Nevada, how often would we need to redesign our benefit program and at what cost to our employees, employers, and taxpayers if our goal is to maintain benefits similar to our current structure.

Current plan members are rightfully concerned that because most benefits come from earnings on investments, reduction of contribution income into our present plan will threaten their own retirement security as well. New revenue sources would need to be found and most likely in the form of higher contribution rates.

Finally, the Nevada legislature may decide on reduced PERS benefits and contribution levels for new hires to fund the additional Federal tax, but now the bottom line poses a threat to their retirement security.

Mr. Chairman, we recognize the important role Social Security plays in the financial security of millions of Americans, however, we respectfully suggest that mandatory Social Security for State and local government employees will not accomplish any of the long-term funding goals of Social Security and will create tremendous economic burdens for public workers they can ill afford. Thank you, Mr. Chairman.

[The prepared statement follows:]

**Statement of George Pyne, Executive Officer, Public Employees'  
Retirement System of Nevada**

As the Executive Officer of the Public Employees' Retirement System of Nevada (PERS), my statement provides the Nevada perspective on mandatory Social Security coverage and its effect on our members, benefit recipients, employers and taxpayers in Nevada. A summary of our plan provisions and funding structure will serve as a backdrop to discussions of the cost impact and benefit structure differences between PERS and Social Security as it exists today.

The Nevada Legislature established PERS in 1947. At the time of PERS' creation, state and local government employees were prohibited from participating in Social Security. The mission of the system was at that time, and is today, to provide a retirement program that meets the income replacement needs of Nevada's public employees at retirement. The Nevada State Legislature recognized that a pension plan meeting this objective also serves to attract and retain qualified employees whose training and experience benefit all Nevadans.

In contrast, Social Security is a program designed as a "safety net" to guarantee a level of income above the poverty level. The difference in the objectives of these two programs is most noticeable when one considers the higher percentage of pre-retirement income that non-FICA pension plans such as Nevada replace at retirement.

## NEVADA PERS' BENEFITS STRUCTURE

Presently, more than 70,000 state and local government employees are members of PERS. We have over 19,000 benefit recipients receiving various types of allowances from PERS. Nevada provides a comprehensive benefit program to its members and beneficiaries which includes service retirement, disability, and pre-retirement survivor benefits. In a state whose population is approximately 1.8 million, we estimate the System has some financial impact on 1 out of every 5 Nevadans, and infuses over \$300 million annually into the Nevada economy.

*Service Benefit:*

Prominent features of our plan include 5 year vesting (as opposed to 40 quarters under Social Security) and a 2.5% multiplier for each year of service up to 30 years. This translates into replacement of pre-retirement income of up to 75 percent. Benefits are calculated using the average of a retiree's highest 3 years of earnings, insuring the initial benefit amount accounts for recent cost of living increases. After retirement, cost of living adjustments from 2%-5% are paid annually based upon the number of years a person is retired. Therefore, like others in our industry, we take exception to the Social Security Advisory Council's suggestion that Social Security is superior to state and local pension plans.

Regarding portability, Nevada provides 100% intrastate portability amongst Nevada employers, and further allows members to purchase up to 5 years service credit without regard to previous public service, thereby enhancing their retirement benefit.

*Public Safety Benefit:*

Our pension plan also recognizes the need for earlier retirement eligibility for its police and fire members. A 1987 study recognized that physical ability declines with age and a youthful more vigorous front-line public safety work force is needed to protect the public. Social Security provides no flexibility to offer early retirement to address this important public safety issue.

*Disability and Survivor Benefits:*

In addition to service retirement eligibility beginning at age 65 with 5 years of service, disability benefits are payable to members with 5 or more years of service who become disabled from the performance of their job or a comparable job. Survivor benefits may be payable for the lifetime of the surviving spouse, and until age 23 for dependent children if they remain in school.

## FINANCING NEVADA PERS BENEFITS

Our investment program plays an integral role in funding the benefits of the System. Unlike Social Security, PERS is funded on an actuarial reserve basis. This means contributions paid to the System today are set aside and invested to fund future benefits. In fact, the great majority of benefits paid by PERS come from return on investment. This focus on investment performance is amplified by the reduction in the ratio of active members to benefit recipients as America ages. Without this funding mechanism in place, delivery of benefits with certainty into the future is threatened.

Nevadans can ill afford the financial burden associated with mandatory coverage. Nevada is among the fastest growing states in the nation with an annual population growth rate of over 5%. As population grows, so to grows the need for additional public services. Our public employee population is increasing at a rate of 4% annually to address this growing need for public service. Recent estimates by the System's actuary project the first year cost of covering new hires of the System under Social Security to be approximately \$27 million. After 5 years, the cumulative cost will increase to \$157 million and to \$384 million after 10 years.

Considering these costs, overlaying Social Security on our current benefit structure results in significantly higher actuarially determined contribution rates. Expressed as a percentage of payroll, contribution rates for new hires would increase from 18.45% and 27.95% to 30.85% and 40.35% for regular members and public safety members respectively. Obviously this is cost prohibitive.

By replacing our current benefit structure with one which attempts to mirror current PERS benefits but with payments from two sources, PERS and Social Security, overall cost is reduced but not back to our current contribution rates. Under the scenario where benefits remain the same, contribution rates still increase to 27.1% for regular members and 40.2% for our police/fire members. This shows that Social Security does not buy as much replacement income at retirement as does PERS. More-



over, employees in this scenario would be taking a 6.2% pay cut in the form of a FICA tax contribution just to maintain their current benefit levels.

If our objective is to keep overall plan costs identical to current rates and be cost neutral to both the employee and employer, as both share in the costs, benefit levels would be reduced significantly. It is estimated the service time multiplier for new hires would be 1%. For a career employee of 30 years the resulting benefit would not serve as adequate replacement income when combined with Social Security.

#### IMPACT OF MANDATORY COVERAGE

Mandatory coverage of new hires is likely to have an adverse impact on current members of the System as well. Our actuarial analysis is not complete. However, it appears the lack of new entrants will increase the unfunded liabilities and extend the time period in which to fully fund promised benefits. Because our System pre-funds benefits, the influx of new member contributions is important to maintain a flow of funds to be invested that will support future benefits. Our actuarial method depends on these contributions to avoid underfunding. If the amount of funds are inadequate to support the benefit structure, contribution rates for current plan members will have to be increased. Benefits for current plan members cannot be reduced because Nevada courts have ruled PERS benefits to be a property right. The state's contractual obligation requires benefits to be maintained or replaced with equal or greater benefits.

An unfunded mandate like Social Security will require a drastic redesign of a pension plan that does exactly what it is intended to do, provide Nevada's public employees a reasonable base income at retirement. PERS Board and the Nevada Legislature will face tough choices regarding contribution rates, benefit levels, and amortization periods. Additionally, the Nevada Legislature must look at services provided to our taxpaying public, and perhaps make reductions in those services to free up the funds to pay for this costly benefit change. All this happens at a time in Nevada where we must increase services due to our greatly expanding population base. The general funds of every public employer in the state will be affected by any increase in the contribution rates.

No matter how we look at it, individual plan members are likely to suffer the most from mandatory coverage. Contribution rates will either increase with no real increase in benefits, or benefits will diminish for the same overall cost that existed prior to mandatory coverage. Other considerations involve the additional costs in administration of a second tier of benefits for new hires to include pre-retirement counseling, record keeping, and benefit determination.

In summary, we are opposed to mandatory Social Security of state and local government employees. It would cause serious disruption to our well-founded, well-funded and well-designed public employees' retirement system.

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Chairman BUNNING. Thank you, Mr. Pyne. I'm going to start off the questioning with Sergeant Pfeifer, because some of the things that he said are really critical. You said that 76 percent of public personnel do not participate in Social Security. Now, you also raised an excellent point which is that law enforcement and other public safety officers retire at a much earlier age than more typical government employees. I'm wondering what happens to those safety officers that are covered under Social Security. Do their plans which may be a combination of Social Security and an employer pension, pay some type of transition benefits until Social Security kicks in?

Mr. PFEIFER. Typically, what happens is the benefits are coordinated with Social Security so that the plan will carry you a certain number of years. Let's say you retire at age 55, they carry you the additional 10 years with your current retirement plan at a level—in the good plans which are funded—at a higher level. Then, once you get to the age where you hit Social Security there will be an offset and Social Security will pick up a piece of that, so that the

expense to the local or the State government will decrease once you hit 65 and you integrate with Social Security.

Chairman BUNNING. But they will maintain the same level of benefits. In others words, say they're getting \$1,000, and they hit 65, what benefit would they then receive? Would they receive more than \$1,000 or would they receive the same benefit when Social Security is included?

Mr. PFEIFER. When Social Security kicks in, in some plans, and it varies—because all these plans vary according to how they're structured—in some plans, the \$1,000 would be reduced to reflect the contribution provided by Social Security, and because you've touched on that, what we're really talking about here are replacement rates and how much of your income you're going to replace at the time you retire.

Chairman BUNNING. That's right. That's what I'm trying to find out.

Mr. PFEIFER. Individual plans do not always keep pace with inflation. They do not have escalators built in like Social Security does with the CPI, Consumer Price Indexes. So, some of these plans—let's say if you retire at a relatively generous benefit at 60 percent of your salary the day you retire. If you have no CPI provision in there that continues to keep you up with the cost of living and you live 20 years more, and the inflation rate is only the current 2.5 or 3 percent today, you've lost about 60 percent of your earning capacity if you have absolutely no CPI in there. So, what happens is you have to go out and get another job to augment that if that's the case. If you're fortunate enough to have an escalator in there which will keep you up with inflation like Social Security does, then you're much better off, and that's one of the positive features of Social Security, the fact that you do have CPI built into it, so that you're always staying relatively current with the cost of living.

Chairman BUNNING. Do you know what the average age of the police officers and the safety officers retirement is?

Mr. PFEIFER. It would vary from State from State. Generally speaking, now, it would be somewhere between 50 and 55 years.

Chairman BUNNING. The reason I ask that is I have a police officer who happens to be my field representative, and he retired very early and became a member of my staff, and now he's paying Social Security and will not only get his retirement from the police but he will get Social Security added on top of that when he becomes old enough to retire from public service in the congressional office.

How does a disability plan—and I'm staying with this before I let others inquire—how do the disability plans offered police and fire fighters by their State and local retirement plans differ from the Social Security Disability Program?

Mr. PFEIFER. Generally speaking, of course, varying from locality to locality, State to State, the disability provisions vary widely. The disability provision for Social Security itself is a very high bar to get over, because you have to be almost totally and permanently disabled, and you cannot really be employable per se.

Chairman BUNNING. You do have to be permanently disabled.

Mr. PFEIFER. That's Social Security. Now, in public safety, the bar is lowered, because consideration is given to the fact that if a

officer is injured in the line of duty and is no longer fit to perform public safety jobs such as riding a scout car on the street, riding the back step of a firetruck, then we need to make a provision to compensate the member as much as possible and make them whole.

Chairman BUNNING. Do they have percentages of disability and things like that?

Mr. PFEIFER. Percentages of disability vary widely. Again, it could vary—some plans—from 20 percent depending on the extent of the disability up to about two-thirds disability.

Chairman BUNNING. And that would include of the salary that you were making at the time that you were partially or permanently disabled?

Mr. PFEIFER. Of the base salary. Now, the key thing to consider when you look at disability is because it is disability income, that is not taxable. So, that is tax free, so whatever percentage you get, unless you change it today or sometime soon, is going to be tax free. If you retire on an optional retirement or a standard retirement then you pay taxes on that money. So, someone who retires, let's say, on a—

Chairman BUNNING. Except if you live in Kentucky, you don't.

Mr. PFEIFER. I might have to move there. [Laughter.]

So, if you retire on disability, you pay no Federal tax. In most cases, you pay no State tax. If I retired on the same amount on a optional retirement, as we call it, I would pay Federal tax, and I would be in the 28-percent tax bracket, probably, so I'd be paying a significant amount.

Chairman BUNNING. I'm going to submit some questions to others that are at the table in writing, and I would appreciate your participation.

[The questions and answers follow:]

#### **Responses of Sgt. Marty Pfeifer to Mr. Bunning's Questions**

*1) Should mandatory coverage of newly hired employees be enacted, potentially resulting in a lowering of retirement benefits and/or salaries? What would be the impact on the ability for safety officers to recruit new hires?*

No, the National Fraternal Order of Police vehemently opposes any Social Security reform measures that include mandatory participation of public employees, newly hired or otherwise.

The answer for this is simple; it is a question of fairness to those law enforcement officers, public safety officials and other public employees who have chosen not to participate in the Social Security system. All are much better served, in terms of benefits and retirement income, than they would have been or would be, if the Federal government mandated Social Security participation. To do so endangers the plans and the retirements of employees currently in other public pension systems and may jeopardize the ability of local law enforcement to fulfill their public safety mission.

Social Security coverage varies considerably by employee group, but according to the Public Pension Coordinating Council (PPCC), seventy six percent (76%) of public safety personnel do not participate in the Social Security program. These employees represent a sizable portion of the State and local government workforce, approximately 3.9 million full-time employees.

If the Federal government imposes mandatory Social Security participation, even if restricted to new hires (a term which does not have a clear definition), it not only compromises severely the financial solvency of existing pension and retirement plans, but does not consider the immense cost to States, localities, and the individual employees. Both the employee and his or her employer would each be required to pay 6.2% of payroll into the Social Security trust fund. This amount would be

in addition to the contribution already paid by the employer and the employee into the State or local retirement system.

I cannot overstate the damage that would be done to State and local governments and the families of the employees if the Federal government forces them to pay a new tax of 12.4%.

Collected data shows that the first year cost to employers—local and State governments—of covering newly hired employees would be over \$771 million. The newly hired employees would be responsible for an equal amount, making the cost of the first year of coverage over \$1.5 billion. The total annual cost to employers for covering employees not currently covered under Social Security would be \$8.5 billion. When the employees' share is counted, that amount rises to over \$17 billion per year.

For example, of the over 240,000 State and local employees in the State of Kentucky, more than 61,000—many of whom are law enforcement officers—do not currently participate in Social Security. The annual cost of mandating participation would be approximately \$80.9 million a year.

Federally mandated participation in Social Security is not a minor issue. Such a mandate would adversely affect millions of employees and impose billions of dollars in additional costs to State and local governments who are trying to stretch every dollar at the local level.

In real terms, this means that local and State government officials would be under tremendous pressure to change these pension systems, pitting the public safety officers against elected officials—something that no one wants. Even if the current pension systems, which would be extremely difficult to change, were maintained a Social Security tax on employees and their government employers would negatively impact public safety operations. The added financial burden at the local and State level could result in layoffs, reduced pay or other benefits, no cost-of-living increases and could reduce purchases of necessary equipment and technology, or even a combination of these consequences. Too many law enforcement agencies in our nation are forced to “make do” as it is, and adding this new unfunded Federal mandate would inflict greater hardship on the State and local governments budgetary concerns.

Also of great concern to our membership is States who can change their pension systems without going through the collective bargaining process. Facing public pressure against tax increases, the legislatures in these States would likely change them, making them much less beneficial to public safety employees. State and local government pension contributions to these systems are likely to be reduced, probably dollar for dollar for allocation to Social Security taxes.

Congress and the Administration should carefully weigh any proposal that would cut the take-home pay of public safety officers—even if just the new hires—by 6.2%, the additional amount they would have to pay out under the mandatory participation plan. Would we retain or recruit the best officers if current pension systems are severely curtailed—reducing substantially or eliminating the much-needed provisions relating to early retirement, line-of-duty disability and early death benefits—so that the total percentage of both the employing agency and employee contributions remain about the same, once Social Security taxes are factored in? Would we get the very best officers if the employing agency also reduces the future pay raises or freezes cost-of-living or other increases, in order to pay its portion of the new Social Security tax? The answer is obviously not.

Imposition of this tax would negatively affect government expenditures on policing innovations, technology and crime-fighting equipment. It could severely curtail current public safety pension systems, giving employees in these plans, police and firefighters, much less protection than they have now. A new, mandatory tax for Social Security will hurt efforts to recruit and retain the best of public safety officers possible.

The Advisory Council on Social Security recommended that Social Security be extended to all newly hired State and local government employees as a way to raise ten percent (10%) of the money needed to rebalance the program, without defining the term “new hire.” The Council's report also failed to address the impact that mandatory participation would have on employers and employees at the State and local level of government.

Many retirement and pension plans for public sector employees have been specifically designed and refined on the assumption that local governments would not be required to participate in the Social Security system. This was a reasonable assumption since local governments have never been required to pay into the system, which was adopted in 1935 for those who chose to participate.

Also of great concern to law enforcement officers are the very limited disability, death and early retirement benefits of Social Security as compared to current pen-

sion systems for public safety officers. Simply put, the Social Security system is not designed to meet the needs of law enforcement officers and other public safety employees.

Active law enforcement officers are typically younger people. The physical and psychological stress of the job and inherent danger of police work often result in early retirement, and, on no few occasions a job-related disability is part of the reason. In the past fifty years, State and local governments have developed pension systems which acknowledge and incorporate the very different needs of police, fire and other public safety professionals. These systems take into account that law enforcement officers often undergo a career change in middle age, usually in their late forties to early fifties. In many police departments, a large percentage of law enforcement officers will be sufficiently disabled at all ages for varying lengths of time and thus be unable to perform their official duties. Therefore, the governments which employ these officers have recognized that public safety officers need certain protections and benefits which reflect the unique nature of their jobs.

Social Security, on the other hand, provides no comparable disability retirement benefits for public safety professionals. Social Security requires that an employee be completely unable to perform any substantial and gainful employment. This means that a person unable to perform regular and continuous duties as a law enforcement officer, who would, under current local and State plans, receive some disability benefit to supplement a subsequent career at a lower salary, would receive nothing under Social Security.

Additionally, there are others who will not be able to continue performing the duties of a law enforcement officer after reaching middle age (some departments even institute mandatory retirement ages), because of the physical rigors and psychological demands of police work. Such retirements are "early" for other careers, but nor for the public safety professional. They would receive NO Social Security benefits.

Also of particular concern to public safety professionals is the much lower death benefits provided by Social Security. Most current retirement death benefits pay between fifty and seventy-five percent (50-75%) of an officer's salary.

## 2) Comments on the GAO Testimony

We found the arguments advanced by GAO to be unpersuasive in making the case for mandatory coverage. They acknowledge the existence of a "cross over point," about 2050, after which the cost of benefits paid to the public employees will exceed the amount received in taxes.

They contend that mandatory participation is a matter of "fairness." We would strongly disagree, especially on the following points made by GAO in their testimony:

Many public employees in non-covered systems receive Social Security benefits as a result of other covered service.

- This is false. In 1983, Congress adopted the so-called "windfall elimination provision" and "government pension offset" (for spousal benefits), which were expressly designed to prevent public employees from receiving benefits that are out of proportion to their contributions. In fact, both adopted provisions unfairly overpenalize employees who participate in government pension plans in lieu of Social Security. GAO argues—in the very same testimony—that it is difficult to administer the "windfall elimination provision" and "government pension offset." It estimated that total overpayments ranged from \$160 to \$355 million.

Mandatory participation would be fair because Social Security reduces the need for public assistance to the elderly.

- Public plans also relieve society from the need to provide assistance to the elderly, and do so more effectively than Social Security, whose beneficiaries do need SSI (funded out of general revenues) because Social Security benefits are not great enough to support them.

The GAO report also fails to address the special needs of law enforcement and other public safety officers addressed above.

3) *Just as each of you want to protect your citizens' retirement income security, we too have a responsibility for all Americans. Finding a solution that works and is fair isn't going to be easy.*

The Fraternal Order of Police appreciates the complexity of this issue and shares the Subcommittee's commitment to fairness.

We strongly believe that requiring public pensions be scrapped in favor of Social Security coverage, which is less suited to the needs of many public employees, especially public safety officers, is unfair. Unfair and, in the long run, will have negligible impact on the Social Security system.

In short, we do not see any compelling reason why a Federally mandated program which has managed itself into periodic solvency crises is superior to local and State plans designed to meet the special needs of the public employee. Every indication is that these employees are better served by their own plans and would lose a great deal of benefits if forced into Social Security. If fairness is really an issue, then why penalize individuals by forcing them to lose their greater benefits in order to pay for the Social Security behemoth?

The Social Security program is an important source of future retirement protection for millions of Americans, and it requires a long-term solution, not the short-term politically palatable fixes that have been tried in the past. Public pension plans like those in California, Colorado, Massachusetts, Nevada, Louisiana, Ohio, Texas and other States can provide models for reform.

Mandating participation in Social Security is not the right solution, nor does it represent meaningful reform. The GAO testimony and their final report reflects that bringing in new hires would extend solvency for only two years—a minimal impact at best.

In addition, State and local plans which are not covered by Social Security would sustain severe financial damage if they are now required to participate. This would result in less benefits for not only the “new hires” whose participation would be mandatory, but for current members and retirees in a number of the States. Existing systems would be required to alter their asset allocation models, resulting in lower yields therefore accelerating financial impact.

If this is about fairness, Mr. Chairman, we believe it is unfair to change the rules sixty-three years later because the Federal government is looking for an easy way to fund Social Security without making hard choices. The State and local governments who chose not to participate in Social Security did not create this problem, nor did the nearly four million employees who do not pay into the system. But all of them would be paying a hefty price for their previous decision to create their own retirement plans. Destroying the retirement programs of these hard-working Americans and raiding the budgets of State and local governments should not be part of the Federal government's solution.

*4) Your plans are also going to be impacted by demographics. How are your State Legislators or Retirement Boards focusing on this issue and what actions are they considering? Do you expect you will see benefit cuts in the future, even without mandatory coverage?*

Demographics are only one factor in considering the financial health of a plan. Many other factors such as investment guidelines, which are often determined by statute, asset allocation, and benefits structure all have a direct impact on a plans' ability to deliver on benefits promised.

The vast majority of plans that cover public safety employees are “defined benefit” plans. These “DB” plans that are fully funded and have well constructed investment programs allow for changing demographics within the plan structure. Asset liability and strategic asset studies performed every three to five years ensure that appropriate changes are made in a timely fashion.

Plans that are underfunded such as Social Security face serious problems in delivering the benefits promised to the participants and beneficiaries of their respective plans. These structural problems that have gone unaddressed for decades require immediate attention.

Often, the ways chosen to address these structural problems are to reduce benefits, increase funding or terminate the plan. In the case of Social Security, a combination of increased funding and some modification of benefits would be the most appropriate remedy.

Given that the life expectancy of both men and women has increased significantly since Social Security was created over sixty years ago, it would seem appropriate to increase the normal retirement age (NRA) before qualifying to receive certain benefits. Although this is technically a reduction in benefits, if Americans are given sufficient time to plan and invest, I believe this is a reasonable option.

A more aggressive investment approach would also be a way to improve the financial stability of Social Security. This means allowing the investment of Social Security assets in capital markets that until now has not been permitted. Increased investment returns over an extended period of time dramatically improves the financial health of any plan.

The Federal Government as the Plan Sponsor also has a duty to educate the public about the benefits that Social Security can provide and the risk associated with more aggressive investment vehicles such as stocks and corporate bonds. Americans should know that they must plan and carefully invest to accomplish their individual retirement goals.

Unfortunately, for many Americans, Social Security is their only retirement plan. Some form of "forced savings" must be made mandatory for every worker so they have a variety of ways to fund their retirement years. Social Security was never intended to be the only source retirement benefits for Americans. Personal Savings Accounts, 401 Ks and IRAs are all appropriate vehicles to accomplish this goal.

In conclusion, if reasonable modifications are made to Social Security such as increasing the Normal Retirement Age, improved investment performance, and a requirement for all Americans to participate in some form of "Forced Savings" program in addition to Social Security, I believe it that Social Security can be made solvent without a significant reduction in benefits.

Every American must be aware that they are responsible for retirement planning and that early planning combined with an effective investment program will provide sufficient income during their golden years.

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### **Responses of George Pyne to Mr. Bunning's Questions**

*1. You mention that the majority of your benefits paid by your system come from return on investment of your retirement fund. Who manages that fund and how is the fund invested currently?*

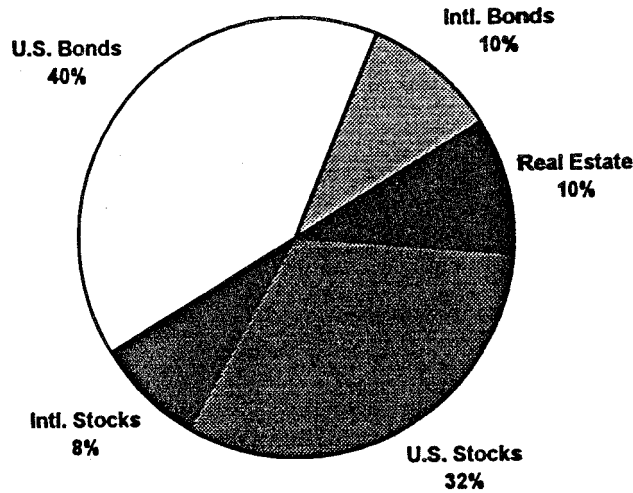
The PERS investment program is designed to generate earnings to fund the System's benefits while minimizing investment risk. By establishing a well-diversified portfolio, PERS has strengthened control over the achievement of those objectives. Through the prudent person standard, the Retirement Board has established investment objectives and policies which recognize future funding requirements based on current membership demographics.

The investment objective of PERS is to:

- produce a total return from investments which, over the long term, exceeds the rate of inflation (CPI) by 3% by capturing market returns within each asset class;
- invest so the short-term volatility of the returns will not cause PERS to alter its long-term investment program;
- structure an investment program which is sufficiently uncomplicated to control PERS' ability to consistently meet return and risk objectives, and
- maintain an investment program which operates in compliance with the Public Pension Principles

PERS' investment portfolio is managed by external investment firms in compliance with the above objectives. PERS employs a number of institutional investment firms to manage its assets. Each of these firms is charged with a specific style mandate and market benchmark. Currently 19 firms manage 23 portfolios for the System. A list of assets managed by each firm follows the response to this question.

One of the key determinants of risk and return is asset allocation. PERS employs a "conservative" asset mix which is designed to provide stable returns through a variety of market environments. Our target asset allocation is:



Nevada PERS Investment Managers

	Hired	Mandate	Asset Size in Millions of Dollars (8/98)
Alliance Capital .....	1986	S&P 500 Index .....	\$ 815
.....	1996	Value Index .....	\$ 337
.....	1998	Growth Equity .....	\$ 388
Atlanta Capital .....	1998	Growth Equity .....	\$ 277
Axe-Houghton .....	1987	Intl. Equity Index .....	\$ 792
Bank of New York .....	1997	Securities Lending .....	.....
.....	1997	STIF Fund .....	\$ 9
Barclays Global Inv. ....	1986	S&P 500 Index .....	\$ 817
Baring Asset Management .....	1997	Intl. Bonds .....	\$ 456
Bradford & Marzec .....	1997	Active Bonds .....	\$ 513
Brinson Partners .....	1990	Intl. Bonds .....	\$ 661
Dresdner RCM .....	1997	Active Bonds .....	\$ 631
Invesco Realty Advisors .....	1992	Real Estate .....	\$ 390
J&W Seligman .....	1998	Value Equity Funded 9/98 .....	.....
L&B Real Estate .....	1989	Real Estate .....	\$ 255
Loomis, Sayles—Detroit .....	1994	Value Equity .....	\$ 328
Nicholas Applegate .....	1976	Active Bonds .....	\$1,059
Pathway Capital .....	1986	Alternative Investments .....	\$ 106
Patterson Capital .....	1987	Active Bonds .....	\$ 540
Payden & Rygel .....	1997	Active Bonds .....	\$ 555
PM Realty Advisors .....	1986	Real Estate .....	\$ 296
.....	1991	Mortgages .....	\$ 4
State Street Research .....	1987	Active Bonds .....	\$1,067
Callan Associates .....	1983	Investment Consultant .....	.....
TOTAL PERS FUND .....	.....	.....	\$10,296

2. Nevada, like a number of other States, cannot reduce benefits for current plan members because Nevada courts have ruled retirement benefits to be a property right. In addition, your State's population base is expanding. How would these factors influence decisions of your State Legislators, should mandatory coverage be enacted for newly hired employees?

Public pension benefits as property rights and Nevada's expanding population are two of several factors that would influence decisions of Nevada lawmakers if mandatory coverage of newly hired state and local government employees is enacted.



Nevada courts adopted the legal theory that its public employees have a contractual (or vested) right to retirement benefits which can not be diminished unless replaced by benefits of equal or greater value. The courts have further ruled that members of our system vest in the benefit structure in place at their time of hire.

Given the above legal framework, the benefits of members hired prior to the effective date of mandatory coverage cannot be diminished or impaired. Unfortunately, the cost to maintain their present benefit package is likely to increase if mandatory coverage of new hires is enacted. This effect is based on our financing structure, which anticipates future members of the system will share with current members in the payment of the System's accumulated liabilities. Currently, that payment is approximately 3.6% of payroll for regular members and 6.02% for police and fire members. Future members will not contribute towards the current System's unfunded liability if they are mandated under Social Security because they would participate in a new plan that is coordinated with Social Security. The lack of new hires coming into the plan will result in higher contribution rates, both for the employees and public employers, because an ever-diminishing group will be contributing to the system.

Additionally, due to the funding inefficiency of Social Security (\$1 invested in PERS provides a much greater return than \$1 invested in Social Security) benefit equality cannot be sustained without significant additional cost to the people of the State. To serve as an illustration of this point, consider the following ramifications for newly hired employees if they are mandated under Social Security:

- Maintain Current Benefit Levels:

If the goal of the Nevada Legislature is to maintain current benefit levels when PERS benefits are combined with Social Security contribution rates would increase from 18.75% to 27.1% of payroll for regular members.<sup>1</sup>

- Maintain Current Cost Levels:

If the Legislature wanted to retain current budgetary pension costs only 6.05% would be available for PERS funding. This results in a service multiplier of between .7% to .9% (our current multiplier is 2.5%) and a drastic reduction in income replacement levels when PERS is combined with Social Security.

New hires will be faced with substantially higher costs for benefits similar to current employees, or lower benefits for the same cost. In either instance there is little or no room for them to participate in payment of the System's liabilities.

The problem is further exacerbated by Nevada's expanding population base. Our actuarial projections anticipate an accelerated growth rate for our system which translates into lower contribution rates. The positive result of this growth is negated if new hires are mandated under Social Security.

*3. GAO did a great deal of work, as you heard in Ms. Fagnoni's testimony, analyzing State and local retirement systems. Her staff met with many of your representatives. I want to give you the opportunity to comment on her testimony or GAO's responses to the questions that were asked of them. Do any of you have any comment you would like to make in response to the GAO testimony?*

It is clear from the GAO report that the principal motivation behind Social Security reform is to address Social Security's financial shortfall. The GAO estimates that mandatory coverage would extend the trust fund's solvency by 2 years. This "so-called benefit," however, would come at a tremendous cost to taxpayers, employers, and employees in their respective states and local jurisdictions—and eventually to Social Security when benefits come due.

To say as the GAO report does on page 21 under *Conclusions* that "the implications for mandatory coverage are mixed" downplays the serious disruption mandatory coverage will bring to the taxpayers, public employees and public employers of Nevada. First, consider the impact on contribution rates. In order to provide the same retirement package for new employees as current employees, retirement costs would not just "increase" they would rise to a cost prohibitive level. In our plan that cost is approximately 9% of payroll! There is also no mention in the GAO report of the psychological and emotional impact on thousands of public employees who will be forced away from the financial security of our present plan to the financial insecurity of Social Security and its extremely inefficient means of funding benefits. Neither does it consider one fundamental principle behind the establishment of our pension plan, to attract and retain qualified public servants. How does a Social Security benefit incent an individual to choose public sector employment? The answer is: it does not.

<sup>1</sup> A significant cost to a state whose payroll is approximately \$2.3 billion.

The GAO report seems to dismiss all of this by further concluding that "Social Security would provide future employees with benefits that are not available, or are available to a lesser extent, under current state and local pension plans." This implies that Social Security provides better benefits than public pension plans, which is clearly not the case.

Nevada PERS provides a comprehensive program of service, disability, and survivor benefits to its members and beneficiaries. Our examination shows that overall we provide a superior benefit package which includes five year vesting, intrastate portability, high income replacement ratios, and funded cost-of-living increases to all benefit recipients ranging from 2%–5% compounded annually. Nevada's program provides more comprehensive benefits and provides more retirement income at a lower cost than does Social Security. Nevada's pension system also addresses the unique needs of the public safety sector such as earlier retirement, an element of coverage sorely lacking in the Social Security system. This will be discussed in great detail below.

The GAO reported cited the 1994–1996 Social Security Advisory Council's conclusion that mandating new hires under Social Security is "an issue of fairness." It is their contention that those of us who do not contribute to Social Security often receive benefits from periods of covered employment or as a dependent of a covered worker and that somehow this isn't "fair." This position ignores that, as covered workers, these individuals did participate in Social Security and are subject to the Windfall Elimination Provision (WEP), just as beneficiaries are subject to the Government Pension Offset (GPO). These programs address the issue of "fairness" as addressed by the Social Security Advisory Council.

If the Social Security Administration finds it difficult to determine whether someone is subject to the WEP or GPO, less drastic measures (than mandating Social Security coverage) could be taken to address this problem. One suggestion is to revise Form 1099R to include a code which indicates a retiree's income is from a governmental pension plan. This would help identify those individuals subject to offset.

There are other issues of "fairness" that weren't addressed in the GAO report. At the time of Nevada PERS creation in 1947, public employees were prohibited from participation in Social Security. Today, Nevada enjoys a financially sound retirement program that guarantees an adequate pension at retirement for its public employees. It is fundamentally unfair for the federal government to force upon our state an unfunded mandate resulting in either the same benefits at greater cost, or reduced benefits for Nevada's public employees. I question the fairness of Congress imposing such taxes on states, cities, and towns, whose local services would be reduced and whose public employees would likely incur benefit cuts.

Regarding issues concerning the public safety sector, the Nevada Legislature determined it is the public policy of the State of Nevada to allow early retirement for police officers and firemen as compared to miscellaneous government employees. This policy is founded on the need to have a younger more physically agile workforce to meet the demands placed on our public safety occupations. Social Security contains no such program. Is it fair to take this benefit away from our public safety employees when early retirement is the legislated policy of the State of Nevada? Moreover, many Social Security reform proposals would extend the normal retirement age past the age 67 threshold.

Policy decisions related to survivor benefits and disability retirement for all of Nevada's public employees have also been addressed by the Nevada Legislature. It is simply a matter of "fairness" that the rules are not now changed in the middle of the game to the detriment of all Nevadans.

*4. Just as each of you want to protect your citizens' retirement income security, we too have that responsibility for all Americans. Finding a solution that works and is fair to each generation of Americans isn't going to be easy.*

*As you have well pointed out, many of your plans replace a higher percentage of pay than does Social Security. GAO, at my request, is taking a look at certain local plans in more detail to assess what Congress might learn from these plans as we consider Social Security reform. Based on the success of so many of your State and local retirement plans, what lessons can we learn from your plans that might work in a solution for Social Security?*

The most important lesson that can be learned from public pension plans is that investments should play a key role in funding the benefits for Social Security. Unlike Social Security, public pension plans are funded on an actuarial reserve basis. This means the investment return on contributions paid to the system is used to fund future benefits. In fact, the great majority of benefits paid by public plans comes from return on investments.

I would suggest that a new Social Security System could look much like today's public pension fund with a well-diversified portfolio designed to generate earnings needed to fund future benefits while minimizing risk. An independent board (or boards—to diversify control of the asset base) could be established to manage the assets of the fund which would include a mix of equity and fixed income securities. The boards would establish investment objectives and policies with an eye on future plan liabilities. They would act as fiduciaries for the benefit of Social Security participants.

Public pension plan boards have other functions as well. In addition to investment policy they also formulate administrative policy and recommend plan design changes to their respective state legislators. By keeping abreast of both economic and demographic changes over time, public plan boards are responsive to the needs of their members and beneficiaries. I believe it beneficial if an independent board(s) for Social Security had similar authority.

*5. Your plans are also going to be impacted by demographics. How are your State Legislators or Retirement Boards focusing on this issue and what actions are they considering? Do you expect you will see benefit cuts in the future, even without mandatory coverage?*

Our State Legislature and Retirement Board are very mindful of changes in plan demographics. From our perspective, demographics are those elements intrinsic to our plan population; including the ratio of active members to retirees, mortality experience, average entry age, average retirement age, etc. The System performs an actuarial valuation each year and a comprehensive experience study every three to five years, to keep abreast of changes in plan demographics. Based on these reviews, assumptions for future plan experience are modified and contribution rates adjusted to maintain the fiscal integrity of our plan.

This process, coupled with benefits that are funded on an actuarial reserve basis works well over time. Demographic changes are evaluated frequently and considered in funding the system on the actuarial reserve basis. As I indicated earlier however, mandatory coverage would change all this and cause a significant disruption to the well-founded structure of our pension plan.

Again, thank you for the opportunity to respond to your questions regarding mandatory Social Security coverage.

Sincerely,

GEORGE PYNE  
Executive Officer

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Chairman BUNNING. Mr. Portman—excuse me, Mr. Neal, first.

Mr. NEAL. Thank you, Mr. Chairman. I have a question for Mr. Lussier. First, I want to thank Mr. Lussier for that wisdom he imparted as a son of Massachusetts to the Subcommittee; a former member of the legislature and you've guys have done a terrific job.

Mr. LUSSIER. Thank you.

Mr. NEAL. In your testimony, Tom, you spoke of what would happen in terms of higher State and local costs if this alteration was made in the Social Security initiative. Would you elaborate on that?

Mr. LUSSIER. Sure. In order, simply, to provide Social Security—based on the employer costs for a new member of our system being on average somewhere between 2 and 4 percent, we could see right on the surface that to go from that number, 2 or 4 to 6, is an increase before we even talk about building any kind of a supplemental as been suggested as a possibility. As a result, we would suggest that what would most likely happen is that we would end up with some form of a defined contribution plan that would be totally funded by employees and would ultimately provide lower benefits to the employees. We also suggest that because of the unique responsibility that the State has assumed for our system for teach-

ers, that there is a huge possibility that the State, obviously, maintaining its commitment to the existing teacher population might opt to provide some sort of a supplemental program, but we think it's more than likely that the Social Security tax component of that would be shifted back to the local cities and towns which would be a total increase of 6.2 percent on cities and towns for teacher costs which they have never borne since the teacher system was established and since it has always been an obligation of the Commonwealth. So, that we think that the effect at the local level could be two pronged. It could be higher costs to provide the benefits that are provided through our many local systems in Massachusetts for their own employees plus the addition of the cost for teachers being shifted from the State to the locals as the State views this as an opportunity to get out from under that new obligation.

Mr. NEAL. Given Proposition 2.5 back in Massachusetts.

Mr. LUSSIER. That's right. Given the local——

Mr. NEAL. You didn't vote for that legislature, did you?

Mr. LUSSIER. No, not at all. [Laughter.]

In fact I had a rather contentious election over that one.

Given the limitations on local tax levies and the improbability of voters voting to raise those levy limits to fund this kind of a benefit, I think you would see that that extra cost would come out of essential services. It would come out of public safety; it would come out of education, and the other services that are provided based on our local property tax base.

Mr. NEAL. Thanks, Tom.

Thanks, Mr. Chairman.

Chairman BUNNING. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman, and thanks for the testimony from around the country and from our safety officers. Mr. Schumacher, good to see you again from my State of Ohio. I have a lot of questions, and I also would ask the Chairman if I could submit some for the record.

Chairman BUNNING. Without objection.

[The questions and answers follow:]

#### **Responses of Richard E. Shumacher to Mr. Portman's Questions**

*1. You mention that over 80% of the benefits paid by your plan come from investment earnings and that your system collects about 22% of covered payroll in employee and employer contributions. Who oversees the investments of the fund and how is the fund invested?*

Answer: The Ohio legislature created the Public Employees Retirement System (PERS) in 1933. The legislation provides that the funds of the system are invested by the system for the exclusive benefit of its members and beneficiaries.

The investment duties of the board are set by statute. Until 1997 the system operated under a legal list of investments. Since 1997 investments are made subject to the prudent person standard. The System's internal professional investment staff manages the investment activities. About 8% of the assets in international investments are managed through external managers. The funds are invested in U.S. equities, U.S. fixed income, real estate, and international equities. The board's investment policy provides for an allocation of the various asset classes. The asset allocation is calculated to determine the optimal mix of asset classes to provide the necessary long-term returns needed to fund the accruing long-term projected liabilities. Portfolio risk is a part of this consideration. The current asset allocation target is U.S. equity, 35%; international equity, 18%; U.S. fixed income, 35%; real estate, 11%; and cash, 1%.

*Follow-up question. Mandatory coverage of newly hired State and local employees would likely result in a lowering of receipts to that fund. What impacts do you see that having in the State of Ohio?*

Follow-up answer: As previously pointed out, over 80% of the benefit payments for PERS are financed by investment earnings. Mandatory coverage of newly hired state and local employees would divert the cash flow from the retirement system to Social Security. If we reduce the flow of funds available for investment, we will reduce investment earnings. For our pension plan to continue the same benefit payouts with such reduction, employee and/or employer rates would have to be increased by 6-7% of covered payroll. The rate increases are an unfunded mandate on state and local governments to maintain the status quo of the benefit payment. The increased rates would not produce any additional retirement or ancillary benefits. The reduction in investment income requires higher contribution rates to provide the same benefit.

*2. GAO did a great deal of work, as you heard in Ms. Fagnoni's testimony, analyzing State and local retirement systems. Her staff met with many of your representatives. I want to give you the opportunity to comment on her testimony or GAO's responses to the questions that were asked of them. Do any of you have any comment you would like to make in response to the GAO testimony?*

Answer: I commend the Government Accounting Office (GAO) for doing a thorough job in researching and writing the Implications of Extending Mandatory Coverage to State and Local Employees.

Perhaps the most striking information is the similarity between their cost analysis and that of the individual state and local government pension plans of the increased cost for moving Social Security uncovered employees into the mandatory coverage. Our actuary has indicated that there would be a five to seven percent cost increase to cover the individuals in Social Security and to maintain our current level of benefits. The GAO publication indicates that it would be a seven percent increase in cost. In most cases, this increased cost would be spent with the individuals receiving the same total benefits as they are currently receiving under the individual state and local government plans. It is noted in the report that the inclusion of state and local government pension plans is estimated to extend the Social Security Administration solvency by only two years.

It appears that the major emphasis in the move to mandatory Social Security coverage is on the short-term cash flow increases. We are unable to discern from the report what increased long-term liabilities for those employees being mandated in would add to future payouts. In her comments, Ms. Fagnoni stated "As with most other elements of the reform proposals put forward by the 1994-1996 Social Security Advisory Council, such as raising the retirement age, extending mandatory coverage to newly hired state and local employees would resolve only a part of the trust funds' solvency problem." This is an indication that mandatory coverage of new hires may not be a wise solution for the funding problem. It could be that the future short-term cash inflow is increased, but that future liabilities are increased by a greater degree. A review of promised benefits versus the sources of income (contribution rates and other income) shall be made to determine that assets are adequate to provide for the benefit payout stream. If assets are inadequate to meet the stream of payments, a fundamental flaw exists and adding more people will not provide long-term stability or solvency.

*3. Just as each of you want to protect your citizens' retirement income security, we too have that responsibility for all Americans. Finding a solution that works and is fair to each generation of Americans isn't going to be easy.*

As you have well pointed out, many of your plans replace a higher percentage of pay than does Social Security. GAO, at my request, is taking a look at certain local plans in more detail to assess what Congress might learn from these plans as we consider Social Security reform. Based on the success of so many of your State and local retirement plans, what lessons can we learn from your plans that might work in a solution for Social Security?

Answer: Social Security is a major factor in the lives of many older citizens of our country. It needs to be viable and financially sound. There are two distinctively different philosophies for funding pension benefits, pay-as-you-go and pre-funding. Under the pay-as-you-go scenario, current contributions collected are used to meet current benefit payments. The long-term effect is the need for greater and greater current contributions to meet rising expenditures. To cover benefit payments for an aging population, extreme pressure is put on increasing inflows.

Using a pre-funding philosophy, contributions are collected and invested. This technique adds a second source of funding. Therefore, the contributions are not the only source of funds to meet payouts. Accumulating assets over a person's working career to provide old age benefits is a good example of maintaining generational equity. When the Ohio legislature created PERS, it delegated the funding of benefits and investment of assets to the retirement system. The state of Ohio, itself, is not involved in the investment of retirement system assets. The basic position is that rates charged to provide benefits must generate sufficient assets to cover the liabilities as they come due. It is imperative that today's collections grown through investment earnings, meet tomorrow's liabilities.

*4. Your plans are also going to be impacted by demographics. How are your State Legislators or Retirement Boards focusing on this issue and what actions are they considering? Do you expect you will see benefit cuts in the future, even without mandatory coverage?*

Answer: The retirement board focuses on demographics during each annual actuarial review. Once every five years a review is done which is the basis for changing assumptions to reflect demographic trends. Liabilities are due over the long-term, therefore, the funding criteria mirrors this long-term period. By beginning with a sound funding policy, year-to-year changes are minimal. For example, the pending retirements of the baby boomer generation are not cause for alarm in our system. The impact will be an increase in cash outflows which will come from the assets accumulated for this purpose.

Absent mandatory Social Security, we do not expect any benefit cuts. However, if there is mandatory coverage, our system will be unable to continue its current ancillary benefit structure.

*5. How are your contribution rates for employees determined so that funds are available to pay promised benefits?*

Answer: The retirement board establishes contribution rates on the basis of actuarial studies. The actuarial studies are performed to determine the future liabilities for benefits established by state statutes. The studies, among other factors, take into consideration the demographics of plan members. Also developed are economic assumptions, i.e., market returns, wage inflation, etc. The result of this effort is a rate structure that will fund retirement benefits over working careers.

It should be noted that the employee and employer contribution rates for PERS have been stable over the last 25 years. While the rates have not increased, there have been benefit enhancements added.

*6. What benefit programs do the contributions support?*

Answer: Besides the vested retirement benefits (age and service retirement, disability, survivor benefits), PERS provides non-vested health care coverage to its retirants and beneficiaries. Through varying techniques, we can provide a health care coverage program funded by employer contributions which are included in the current rate structure. If mandatory Social Security coverage were forced upon this system, because of the reduction in our funding base, this ancillary program would need to be severely curtailed or abandoned.

Cost of living increases (equal to the CPI change but not to exceed three percent) of pension payments are funded under the current rate structure. Again, reductions in our coverage base could require a reduction in the cost of living allowance payments. The overriding discipline for PERS is that adequate funds must be generated to meet the promised liabilities.

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Mr. PORTMAN. Let me, just begin by making a comment and then ask a couple of questions of the Ohio system and feel free to chime in from other States or from the other safety officer plans. My general comment is that we've got a Social Security system that needs reform, and I'm for reform as is the Chairman, that's why we're having these hearings, and, yet, I think it would be an irresponsible thing to simply get an infusion of funds, immediate funds, by taking employees who are currently in systems that work—that are prefunded; that invest in the market; that do all of the things that many of us think we ought to be doing in Social Security—and

throwing them into Social Security without any promise, frankly, that Social Security's going to do those things.

So, I have real concerns about the proposals that we've seen both from the Advisory Committee, Senator Moynihan's proposal, and so on, because I think that they are probably going in the wrong direction. In fact, we need more flexibility in our plans. I'm a big proponent of more flexibility in our pension plans as well through the private sector. In any case, that's kind of the perspective I bring to this which probably doesn't surprise anyone on the panel.

I also happen to be from Ohio where we have a system that works, and that's where I want Mr. Schumacher, to spell it out a little more, because in your testimony you didn't have time to get into some of Ohio's plan. I think it's important for people to understand that the contribution rate is about 23.3 percent of payroll now. Is that correct, when you include the employer contribution and the employee contribution?

Mr. SCHUMACHER. Mr. Chairman, Mr. Portman, it's 21.8 percent.

Mr. PORTMAN. So, it's a relatively high percentage. We're not saying the reason our State employees and teachers and so on don't want to get into the Federal plan is because they are concerned about paying more payroll taxes. It's more in terms of how the plan works, the benefits, and the soundness of it fiscally. The funds are invested. Can you tell us a little more about how those funds are invested?

Mr. SCHUMACHER. Yes, the State legislature has given the retirement systems in Ohio a prudent person rule and the individual boards set up an asset allocation program with a very keen sense of the risk of the portfolio and the maximization of return. The return on investments is a major income stream for the——

Chairman BUNNING. Could you pull the mike to you so that the recorder can hear you better. Thank you.

Mr. SCHUMACHER. The income stream is a major source of earnings for the State of Ohio and that funds a great deal of our benefits. Yesterday, I did review with our board terminations in the State of Ohio in our pension plan for the month of April. The individuals who were terminated over various working careers and retirement careers had paid in, including interest furnished by earnings, of about \$4 million. The payout by the system for those individuals over their retirement years was \$28 million.

Mr. PORTMAN. That's a successful plan. Again, I think when you look at the short-term benefit of including mandatory coverage, it's obvious, but in the longer term, you will not see benefits to Social Security and it's because these folks are going to retire also, and they're going to be a strain on the system eventually. So I think it's a short-term fix that isn't a responsible, structural change in Social Security that we would really need.

Let me just ask you quickly on the taxation. How are those benefits taxed?

Mr. SCHUMACHER. The benefits are taxed under the Internal Revenue Code 100 percent.

Mr. PORTMAN. Fully taxed for Social Security.

Mr. SCHUMACHER. Fully taxed.

Mr. PORTMAN. And how about at the State level.

Mr. SCHUMACHER. The same taxation applies at the local level with the exception that survivor benefits are not taxed in the State of Ohio.

Mr. PORTMAN. One other question I have on the plan. You mentioned briefly that it covers more than just retirement income, and if you could talk a little, particularly, on the health care side, what it provides and what the impact on the health care benefits were there to be mandatory coverage?

Mr. SCHUMACHER. Yes, health care in Ohio is not a mandated benefit. It is a benefit that is provided to be given at the option of the retirement board. Currently, we provide for two PPOs and various health care—Medicare, HMOs—and this is done at zero cost to the original retirement and at a contributing cost for the spouse under the age of 65 of \$60 a month; over age 65, of \$20 a month.

Mr. PORTMAN. Again, an attractive plan and it's working. I would just make a general comment that probably we could learn something at the national level from some of these State plans as we asked GAO earlier.

I would make one other comment which is that the Unfunded Mandate Relief Act did not go through this Subcommittee. I wish it had, but this Subcommittee is very interested in that issue and has used that discipline that we got 3 years ago through that act. It actually came through the government—then called the Government Operations Committee, now, Government Reform and Oversight Committee, but it is certainly the intent of this Congress, this majority in Congress, not to impose unfunded mandates. That's another good point that I, frankly, hadn't thought through until I heard your testimonies this morning. Thank you all for your testimony. Thank you, Mr. Chairman.

Chairman BUNNING. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. As a followup to Mr. Portman, Mr. Schumacher, noticing that the contributions are equivalent to 23 percent—at least 14 and then matching from the employer—how does the actual retirement check from your plan compare to an equal worker of same time, same salary range under Social Security?

Mr. SCHUMACHER. The basic annuity formula is 2.1 percent per year of employment. A person with 30 years of employment can retire at any age on a straight life benefit of 63 percent of their final average salary; that's the average of the highest 3 years of income. If they wish, they can take a joint survivor benefit or they can take a benefit over other lives and as much of 100 percent of what they receive to their spouse or to the beneficiary.

Mr. COLLINS. How would that compare to a worker earning equal pay on their Social Security check that you would know?

Mr. SCHUMACHER. I do not know the answer to that question.

Mr. COLLINS. Yes, sir.

Mr. SCOTT. I think if you take an average worker who earns \$35,000 a year, under our system that worker would get 75 percent of pay after 30 years of service. So, that's somewhere in the neighborhood of \$25,000, \$26,000, \$27,000, \$28,000. Social Security ceiling is in the neighborhood of \$12,000, I believe, now.

Mr. COLLINS. Quite a bit of difference. Mr. Scott, you mentioned that most State and local plans offer considerable portability.



Mr. SCOTT. That's correct.

Mr. COLLINS. How does this work and what is your outlook for increased portability?

Mr. SCOTT. Well, I think portability is probably one of the big issues that our industry—whether it's private sector retirement or public—has to deal with. I mean, it's weak across the whole environment, and, of course, Social Security provides complete portability. We've been working on that, and we've put in place, for example, interest on refunds several years ago; we allow people to buy into the system. If they come in and they've got some money, they buy into the system for public or private sector service. We also have what we call a hybrid; that is if you come to PERA, Public Employees Retirement Association, and you work for, say, 5 or 10 years and you walk out of the system, we will give you your money back, which is at 8 percent, plus we'll match that; give you 2 percent of the employer contribution and then interest at 80 percent of our assumed rate which gives you 8 percent interest. So, on your money you would be taking 32 percent return on that money as you walk out the door. The unfortunate part of that is that most younger people take it and it's gone. As people have more years of service, they generally will take it and roll it over which you've allowed them to do through the Tax Codes.

Now, if you leave the money with PERA—and this is an encouragement to do so—we will, when you retire, give you your 8 percent plus 50 percent match of 4 percent, and then we'll annuitize that because you don't have the full defined benefit. And, so that calculation actually gives you a better benefit than the defined benefit does until you reach 20 years of service, and that annuitized amount is protected completely for cost of living; it gives you access to our retirement health care. So, we think we're making some strides there, and, of course, the big argument is defined benefit versus defined contribution, but that's the way we deal with it.

Mr. COLLINS. OK, very good. Thank you, Mr. Chairman.

Chairman BUNNING. Thank you. I have just one more question I'd like to ask all the panel. Mr. Pyne, I'd like for you to start us off. As you know there are many options being considered for the Social Security reform. One option being put forth by both Democrats and Republicans alike is to create personal retirement savings accounts. If Social Security were to be reconfigured to include such accounts, would State and local employees want to participate?

Mr. PYNE. First of all, I think what's admirable about that is at least the dialog has to do with advanced funding and recognizing the fact that you need to build wealth and the way to do it, not unlike our plans, is to use the power of compounding and the investment markets and advance fund benefits. What you're really doing there, then, is you're becoming more like us in the public sector because that's exactly what we do is advance fund benefits. Now, we do it on a defined benefits basis not so much on a personal retirement account type of a basis, but, at the same time, we're already there, so it would just seem, from my perspective, that we're sort of where I think Social Security needs to go. So, it's not advantageous for us to be moved into that type of an environment. So, I think we're just fine right where we are. Our public employees

can participate in 457 plans and plans of that sort which essentially have the same features, I think, of these personal retirement accounts.

Chairman BUNNING. Would anyone else in the panel like to comment about it?

Mr. PFEIFER. Mr. Chairman, I think, from my personal perspective, that would be a very positive innovation, and the reason I say that is because, as I understand it, the way Social Security is invested, you're invested, basically, in long-term fixed income instruments of the U.S. Government. Now, in a diversified retirement plan such as mine and such as the others sitting around this table, we not only buy fixed income from the United States, we buy U.S. equities, international equities, and a variety of other investment instruments that improve the performance of those funds and improve the investment returns so that you're able to grow the money over time and payout a very generous benefit, hopefully, at the end of the time, because you have so much time to deal with.

The only downside I would see with that is the personal retirement savings accounts, just as with the defined contribution plans, there's a certain responsibility that the employer—in this case, I assume it would be the Federal Government would have—to educate the individuals who participate in that particular option to make sure they know some of the basics of investing so they invest the money prudently and get what they expect. Obviously, certain individuals would be adverse to risk; certain individuals would be willing to take more risk, so I think that's something that would have to be very carefully looked at, but I think that would be a very positive innovation.

Chairman BUNNING. Anyone else? I thank the panel for their participation, and we look forward to dealing with you again. We may submit questions in writing for you to answer for the record. Thank you.

[The questions and answers follow:]

#### **Responses of Robert J. Scott to Mr. Bunning's Questions**

*You make the point that public plans do a good job providing for retirement security for their members. For example, in Colorado, a 15-year employee earning a high of \$15,000 would receive 28.6% of pay under Social Security when he retired, as opposed to 33% under the Colorado plan. You also challenge the Social Security Advisory Council's assertion that Social Security's protection is superior to State and local plans over the course of a lifetime. Would you provide more detail as to how you reach this conclusion?*

It is well established that most public plans provide a strong retirement benefit for their employees at virtually all levels of compensation and all periods of covered service. (We have enclosed copies of a study done by Third Millennium on this subject, but there is a great deal of other evidence that supports this point as well.) These better benefits are possible because of the greater investment return on public pension plan contributions compared to Social Security.

Those who try to argue that Social Security provides better protection over the course of a lifetime generally argue that Social Security provides better ancillary benefits, such as survivor benefits and disability benefits, and Social Security also provides better portability. Also, Social Security benefits are adjusted for the cost-of-living.

In our written testimony to the Social Security Subcommittee (pages 3–4) we covered this topic at length. Ancillary benefits of public plans are generally better than those provided by Social Security. Not only are dollar benefits generally higher, but public plan disability benefits may be easier to qualify for. Disability benefits for public safety workers, such as fire and police officers, are superior in public plans to benefits provided by Social Security. Social Security survivor benefits for children

cut off at age 18. Public plan benefits often extend through college, if the surviving child is a full-time student.

Public plans also provide cost-of-living adjustments for retired workers. In general, the post retirement cost-of-living adjustment is comparable to the Social Security adjustment, except for periods of unusually high inflation. (See, for example, the Third Millennium study, page 16) Public plans account for inflation that occurs during a career by basing benefits on an employee's high three or five year compensation, or on his final three or five years of compensation.

The portability issue is discussed in response to question two.

*You mention that most State and local plans offer considerable portability. How does this work and what is your outlook for increased portability in the future?*

Some people argue that Social Security's greatest advantage is that it is completely portable. It is true that all workers who accumulate the required 40 quarters are entitled to some benefit under current law, although many workers who are in and out of the work force during their careers may receive only a very low benefit measured in dollars. (Those workers having fewer than 40 quarters receive no monthly retirement benefit and no refund of contributions paid.) It is not true, however, that workers are guaranteed a specific benefit through Social Security. Unlike public and private plans, where an employee is vested in a specific "accrued benefit," Social Security benefits may be modified by Congress in ways that are either beneficial or adverse to workers, and those workers have no contractual protection. Benefits in the Social Security program, and other entitlement programs, such as Medicare, have been modified in the past to reduce benefits for current and future participants.

Public plan participants are always 100 percent vested in their own contributions, and interest at a reasonable rate is added. Most public plans use rapid vesting schedules for qualifying for a monthly retirement benefit. Generally the vesting requirement is five years; see Third Millennium study, page 14. Employees are always free to roll over their vested account balance into an IRA, in lieu of any monthly benefit from the public retirement system.

Colorado PERA is a defined benefit plan that really is a hybrid because it includes some of the attractive portability features of a defined contribution plan. Employees who terminate PERA-covered employment before retirement age may elect a refund that includes their own contributions (8 percent of salary) plus interest, and a 25 percent match on that amount. The employee may elect instead to leave the account in PERA and receive at retirement a refund that includes additional accumulated interest plus a 50 percent match, or a lifetime monthly benefit. The lifetime monthly benefit, if elected, is the greater of the benefit based on the defined benefit formula (2.5 percent of high-three-year salary per year of service) or a money purchase benefit calculated by annuitizing the employee contributions plus interest and a 50 percent match. PERA will propose state legislation in 1999 that would increase the matching levels from 25%/50% to 50%/100%.

Colorado's hybrid features recognize that many employees covered by PERA will not retire in a job covered by PERA. These employees have good choices that they can make at termination that will enable them to build up a sufficient retirement income, in or out of PERA. The State Teachers' Retirement System of Ohio has a similar hybrid feature in its defined benefit plan.

PERA's Board of Trustees would also like to propose to the Colorado Legislature that a small portion of future employer contributions be allocated as a partial match to voluntary contributions that employees make to their own 401(k), 457 plan, or 403(b) plan accounts. This may start in 2001, unless Social Security for new hires is mandated, in which case it may not be possible at all.

Public employees in any state can continue earning service credit if they transfer from one job to another within the same system. Some retirement systems within the same state allow service years to be carried into the new system under reciprocity agreements. In addition, most states permit employees to "buy in" past service credits into their retirement plan, often by using money accumulated in a previous employer's plan. According to a survey of 105 plans conducted by the Public Retirement Institute, about 92 percent of statewide public pension plans allow the purchase of service credits.

Colorado PERA for example allows any employee with at least one year of earned PERA service to buy other years earned through prior public or private sector service, provided they are not currently vested for benefits in the previous employer's plan. For employees hired in 1999 or later, federal law limits the number of private sector years that can be purchased to five years. The five year cap is not expected to be a problem for most employees, but Colorado would support an increase or elimination of the cap, if proposed in Congress.

H.R. 3788, the "Retirement Security for the 21st Century Act," by Reps. Portman and Cardin, would enhance the ability of all public employees to purchase service. The bill would allow rollovers from IRC section 457 and 403(b) plans into public defined benefit plans to purchase service. Currently, rollovers to purchase service are only allowed from 401(a) or 401(k) plans, pursuant to federal law. As a result, employees usually purchase service credits in their public plan with after-tax moneys.

*3. In your testimony, you discuss the importance of how "new hire" would be defined, if mandatory coverage for new hires were to be enacted. Would you provide more detail as to why this definition is important and what the impacts are?*

The definition of the term "new hire" will have a substantial effect on the turnover rate. The most important issue is whether or not the term "new hire" will refer only to employees who are not employed by the state or local government in any capacity on the date when Social Security coverage for new hires becomes effective, or whether it will also apply to employees who change jobs within a system, in other words, lateral transfers.

The resolution of this question will affect the short-term cost of mandatory Social Security coverage to government employers. It will also have effects on pension plan assets; the greater the number of new hires, the lower the amount of new money which is contributed to the pension plan. In addition, there may be a "lock in" effect for some employees who may be reluctant to change jobs if such a change would result in having to pay the Social Security tax.

*4. GAO did a great deal of work, as you heard in Ms. Fagnoni's testimony, analyzing State and local retirement systems. Her staff met with many of your representatives. I want to give you the opportunity to comment on her testimony or GAO's responses to the questions that were asked of them. Do any of you have any comment you would like to make in response to the GAO testimony?*

We were pleased to see that the GAO report acknowledges the existence of a cross over point, after which the cost of benefits paid to public employees will exceed the amount received in taxes. GAO estimated the cross over point to be 2050. (Page 9 of the report)

We were also pleased to see GAO acknowledge (page 20) that administrative problems would require at least a four year lead time for public employers to adjust to a system of mandatory coverage for new hires.

We found the arguments which GAO discussed in favor of mandatory coverage to be unpersuasive. GAO discussed the so-called "fairness" issue, for the most quoting or referring to arguments made by others. This issue of fairness is discussed at great length in my written testimony, pages 7-10.

It is hard to believe, at this point in time, that anyone knowledgeable can argue that mandatory coverage is fair simply because many public employees in non-covered systems receive Social Security benefits as a result of other covered service. The windfall elimination provision adopted in 1983 and the government pension offset (for spousal benefits), which were expressly designed to prevent public employees from receiving benefits that are out of proportion to their contributions, should dispose of this point once and for all. But the argument appears at page 10 of the GAO report.

GAO also quotes others as arguing that mandatory coverage would be fair because Social Security reduces the need for public assistance to the elderly, or because the parents of public employees may receive Social Security benefits. But public plans also relieve society from the need to provide assistance to the elderly, and may do this more effectively than Social Security, some of whose beneficiaries do need SSI (funded out of general revenues) because Social Security benefits are not great enough to support them. If the parents of public employees receive Social Security, it is presumably because those parents made Social Security contributions. Moreover, the children of public employees will generally make Social Security contributions, even through their parents receive no benefits or reduced benefits.

The GAO also argued that it is difficult to administer the Windfall Elimination Provision and the Government Pension Offset, and "estimated ... total overpayments to be between \$160 million and \$355 million over the period 1978 to 1995." In the context of the Social Security funding deficit, as well as the harm that would be done to public plans by mandatory coverage, the amounts cited are trivial. The report noted that additional data matches by SSA, with cooperation from non-covered retirement systems, will be implemented to improve administration of the WEP and GPO reductions. The GAO also believes that there is a significant risk that some state and local employees will not be covered under either a public plan or by Social Security, as required by OBRA 1990. From our experience, there is no significant risk of noncoverage. SSA, the IRS, and state and local officials have developed

manuals and other programs to help make sure every employee is covered under an approved plan. This is no reason to mandate Social Security coverage for state and local workers.

As for the financial benefits of mandatory coverage, GAO largely relies on the estimates of others that mandatory coverage would solve about 10 percent of Social Security's actuarial problem. If true, this is because contributions will be received throughout the 75-year period, while many of the liabilities accruing because of those contributions will not have been paid. In any event, if contributions are not saved, rather than used to fund operating costs of the government, mandatory coverage will not help Social Security at all, except perhaps during a relatively brief period when no benefits are being paid.

*5. Just as each of you want to protect your citizens' retirement income security, we too have that responsibility for all Americans. Finding a solution that works and is fair to each generation of Americans isn't going to be easy.*

*As you have well pointed out, many of your plans replace a higher percentage of pay than does Social Security. GAO, at my request, is taking a look at certain local plans in more detail to assess what Congress might learn from these plans as we consider Social Security reform. Based on the success of so many of your State and local retirement plans, what lessons can we learn from your plans that might work in a solution for Social Security?*

CPRS takes no position on whether or not Social Security should be subject to structural reform, or what the nature of that reform should be if it occur. Of course we are willing to share our experience in devising and funding our retirement plans, for whatever relevance that experience may have.

Colorado PERA, like most public plans, is a defined benefit plan. Plan contributions are pooled for investment purposes, allowing for great diversity of investment and eliminating the possibility that a particular employee could be adversely affected by poor investment choices. Also, while public plans generally provide rapid vesting, there are some plan forfeitures of employer contributions by short term employees, and these forfeitures help meet the funding requirements of the plan.

Unlike Social Security, however, state and local retirement plans are funded. Most benefits, and many plan improvements, are paid for out of investment earnings on contributions. In my written testimony, I pointed out that STRS of Ohio estimated that the average retired employee lived for 26 years after retirement. Three years of benefits are paid for out of employee contributions, six years are paid for out of employee contributions, seventeen years of retirement benefits are paid for out of investment earnings on contributions.

Earlier I pointed out that Colorado PERA and most other public plans do an excellent job of providing ancillary benefits and cost-of-living adjustments for retired workers. Many of these benefits are paid for out of earnings on investments.

It is important to be aware that ancillary benefits and cost-of-living adjustments are easier to provide because of the defined benefit structure of most public plans. Most proposals for restructuring Social Security envision private individual accounts, in which retirement benefits are based on the amount in the account at retirement. It would certainly be possible to provide ancillary benefits and cost-of-living adjustments under such a structure, but it would be difficult if most of the funds are contained in individual accounts.

If there were no pooling of investment and risk, ancillary benefits would have to be provided out of the employee's individual account, probably by some form of insurance. This would reduce the value of the employee's retirement account and would require regulation of the insurance providers to deal with such issues as adverse selection.

Cost-of-living adjustments could be purchased as part of an annuity, but there would be no way for the retiree to achieve cost-of-living adjustments, or other plan improvements, from favorable post-retirement investment experience. Public plans, with their large pool of assets and defined benefit structure, are able periodically to provide plan improvements for retirees and current plan participants out of favorable investment experience. At the same time, contribution rates for many public plans have been reduced slightly over the last decade.

It is well worth noting that women face special problems under an individual account system. Many women go in and out of the work force, reducing lifetime contributions to a retirement plan. Also women generally live longer than men, meaning the proceeds of a defined contribution account would have to last them longer.

People who go in and out of the work force also see their benefits reduced under Social Security and defined benefit public plans, but probably not to the same extent as would be the case in a defined contribution plan. Moreover, Social Security and most public plan benefits are provided in the form of a lifetime annuity, and are

adjusted for inflation pre-and post-retirement. These factors tend to mitigate the effects of having a shorter career. Colorado PERA encourages its members to contribute on a voluntary basis to defined contribution plans, to foster increased portability and to help supplement their basic income during retirement.

*6. Your plans are also going to be impacted by demographics. How are your State Legislators or Retirement Boards focusing on this issue and what actions are they considering? Do you expect you will see benefit cuts in the future, even without mandatory coverage?*

Colorado PERA and other public plans are funded on an actuarially sound basis. Contributions are fairly level as a percentage of payroll. This level-cost funding helps assure over the long term that benefits promised will be paid when they become due. PERA's trustees and independent consulting actuary compare actuarial experience against assumptions every year, and actuarial assumptions about mortality, salary increases, turnover, etc., are usually adjusted every five years based on significant changes in trends. Public plans use reasonable assumptions about the rate of investment return in funding plan liabilities; the average assumption is about 8 percent per year.

Public plans and private plans have recognized for years that the ratio of active employees to benefit recipients has decreased, and will continue to do so. In contrast to Social Security, no benefit reductions or contribution rate increases are expected to be necessary to pay benefits. In the absence of mandatory Social Security, Colorado PERA will be able to pay plan benefits that are provided by Colorado statute without contribution rate increases. Over the years, as progress has been made in amortizing unfunded actuarial accrued liabilities, plan benefit provisions have been improved at times.

On behalf of all the members of the Coalition to Preserve Retirement Security, thanks again for the opportunity to provide information to the Subcommittee on this important issue.

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The final panel we'll hear from testimony: Robert Normandie? Normandie—oh, I can see it better out there, OK. Ms. Jergen, is that fair?

Ms. JERNIGAN. Jernigan.

Chairman BUNNING. Jernigan. And Joseph Rugola.

Mr. RUGOLA. Very good, Mr. Chairman. Thank you.

Chairman BUNNING. OK. Robert is chairman of the Coalition to Assure Retirement Equity. Ms. Jernigan is a chapter member of the National Association of Retired Federal Employees, and Joseph is the international vice president of the American Federation of State, County, and Municipal Employees and is the executive director of the Ohio—what is this, Rob?

Mr. PORTMAN. You represent greater Ohio, so I thought it was appropriate. [Laughter.]

Chairman BUNNING. OK—and is the executive director of the Ohio Association of Public School Employees.

Mr. Normandie, go ahead.

#### **STATEMENT OF ROBERT E. NORMANDIE, CHAIR, COALITION TO ASSURE RETIREMENT EQUITY**

Mr. NORMANDIE. Mr. Chairman and Members of the Subcommittee, I'm Robert Normandie, legislative researcher for the National Association of Retired Federal Employees. However, I'm here today testifying as chair of the Coalition to Assure Retirement Equity, CARE; a coalition of 41 organizations representing millions of Federal, State, and local government retirees and employees.

CARE was formed in 1991 to specifically address the Social Security government pension offset, GPO, which had been enacted as

part of the Social Security amendments in 1977. Since December 1982 when the law went into effect, some 271,000 Federal, State, and local retirees have been affected by the GPO.

The GPO has particularly affected the economic well-being of thousands of women by severely reducing or eliminating their Social Security widow's benefits. I personally have heard from hundreds over the past several years, and their stories have a lot of similarities. Many worked in lower-level jobs and receive moderate pensions and may have worked part time or full time after raising their children. When they go to the Social Security office to apply for benefits, usually as widows, they are shocked and dismayed to find out about the GPO. The widows' benefit they expected to receive is drastically reduced or eliminated, and they really do not know how they are going to survive on a pension that barely pays the rent. The reaction of everyone is the same: They all feel they have been penalized because they worked for the government. If they had worked in the private sector, say for IBM, they could receive a company pension and still get their husbands' Social Security. In addition, if they had also worked in the private sector and earned enough Social Security credits, they find that their own Social Security benefit is reduced by 50 percent or more by the windfall elimination provision.

The WEP, enacted as part of the 1983 Social Security amendments, has affected some 356,000 government retirees since 1986. The GPO and WEP were a part of the 1977 and 1983 congressional efforts to curtail the costs of the Social Security Program in the context of long-term solvency. The GPO applied Social Security's dual entitlement provision to all government pension programs that covered workers not covered by Social Security. Initially, this meant Social Security spouse benefits would be offset by 100 percent of the non-Social Security covered government pension. This was changed to two-thirds in 1983 on the basis that one-third of the pension was equivalent to a private sector pension.

The Social Security Subcommittee in a 1996 information paper on GPO and the WEP said, "There is nothing magical about the two-thirds figure, and it is the source of much controversy. In fact, there is tremendous variance in the actual individual equivalent depending on length of government career and average salary." The paper also quoted a 1990 Congressional Research Service analysis that stated Social Security was the equivalent of 51 percent of the civil service benefit of an average retiree in 1990 which would support at least a one-half offset rather than two-thirds. The House, in fact, had passed a provision that would have reduced the offset to one-third. This occurred just prior to Congress' reduction of the offset from 100 percent to two-thirds.

This same Congressional Research Service analysis concluded by stating, "The part of the CSRS, Civil Service Retirement System, benefit, that can be considered to be the equivalent of Social Security covers a very wide range depending on the circumstances of each individual. Because of this variability, all inclusive conclusions about the generosity and fairness of CSRS benefits and the general equity of the two Social Security antiwindfall measures, GPO and WEP, are probably inappropriate. The various illustrations indicate, however, that the antiwindfall measures miss the

mark considerably for many civil service retirement system annuitants.

In summary, the GPO and WEP have had a devastating effect on the retirement incomes of many Federal, State, and local government retirees. It is hoped, Mr. Chairman, that your Subcommittee will seriously consider changes to the GPO and WEP provisions of the Social Security Act to provide a more equitable solution. Thank you.

[The prepared statement follows:]

**Statement of Robert E. Normandie, Chair, Coalition to Assure Retirement Equity**

Mr. Chairman and members of the Subcommittee, I am Robert E. Normandie, legislative researcher for the National Association of Retired Federal Employees. I am here today testifying as Chair of the Coalition to Assure Retirement Equity (CARE), a coalition of 41 organizations representing millions of federal, state and local government retirees and employees.

CARE was formed in 1991 to specifically address the Social Security Government Pension Offset (GPO) which had been enacted as part of the Social Security Amendments of 1977. Since December of 1982, when the law went into effect, some 271,000 federal, state and local retirees have been affected by the GPO.

At the time of formation of the coalition a House bill to repeal the GPO had been introduced and bills to either repeal or amend the GPO have continued to be introduced in each subsequent Congress. The Windfall Elimination Provision (WEP) bill introduced by Rep. Barney Frank last year is the first such bill, to my knowledge, that has addressed the WEP.

The GPO has particularly affected the economic well being of thousands of women by severely reducing or eliminating their Social Security widow's benefits. I personally have heard from hundreds of women over the past several years and their stories have a lot of similarities. Many worked in lower level jobs and receive moderate pensions and may have worked part time, or full time, after raising their children.

When they go to the Social Security office to apply for benefits, usually as widows, they are shocked and dismayed to find out about the GPO. The widow's benefit they expected to receive is drastically reduced or eliminated, and they really do not know how they are going to survive on a pension that barely pays the rent.

The reaction of every one is the same. They all feel they have been penalized because they worked for the government. If they had worked in the private sector, say for IBM, they could receive a company pension and still get their husband's Social Security.

In addition, if they had also worked in the private sector and earned enough Social Security credits they find that their own Social Security benefit is reduced by 50% or more by the WEP. The WEP, enacted as part of the 1983 Social Security Amendments, has affected some 356,000 government retirees since 1986.

The GPO and WEP were part of the 1977 and 1983 Congressional efforts to curtail the costs of the Social Security program in the context of long term solvency. The GPO applied Social Security's dual entitlement provision to all government pension programs that covered workers not covered by Social Security. Initially this meant Social Security spouse benefits would be offset by 100% of the non-Social Security covered government pension. This was changed to two-thirds in 1983 on the basis that one-third of the pension is equivalent to a private sector pension.

The Social Security Subcommittee in a 1996 information paper on GPO and WEP said "there is nothing magical about the two-thirds figure, and it is the source of much controversy. In fact, there is tremendous variance in the actual individual equivalent depending on length of government career and average salary." The paper quoted a 1990 Congressional Research Service (CRS) analysis that stated Social Security was the equivalent of 51% of the civil service benefit of an average retiree in 1990 which would support at least a one-half offset rather than two-thirds. The House, in fact, had passed a provision that would have reduced the offset to one-third. This occurred just prior to Congress' reduction of the offset from 100% to two-thirds.

This same CRS analysis concluded by stating, "the part of the CSRS [Civil Service Retirement System] benefit that can be considered to be the equivalent of Social Security covers a very wide range, depending on the circumstances of each individual. Because of this variability, all-inclusive conclusions about the generosity and fairness of CSRS benefits, and the general equity of the two Social Security anti-



windfall measures [GPO and WEP], are probably inappropriate. The various illustrations indicate, however, that the anti-windfall measures miss the mark considerably for many CSRS annuitants."

In addition to proposals to reduce the GPO to one-third or one-half, one House bill in a prior Congress would have eliminated the offset for retirees whose combined monthly government pension and spousal Social Security benefits were below \$300. For those with combined pensions and Social Security between \$300 and \$900 the bill would have increased the offset rate gradually to the full two-thirds.

CARE has supported Rep. William Jefferson's GPO bills that would eliminate the offset for any government retiree whose combined monthly pension and spousal Social Security benefits are \$1,200 or less. If the combined amount is over \$1,200 then only that amount over the \$1,200 would be subject to the two-thirds offset. Rep. Jefferson's bill has 161 cosponsors which indicates a fair amount of support.

Rep. Frank's bill would eliminate the WEP for any government retiree who has combined monthly pension and Social Security spousal benefits of \$2,000 or less. For those with combined amounts between \$2,000 and \$3,000 the WEP is phased in. This bill would increase the Social Security benefits of about 93% of those who are currently affected by the WEP.

Realizing the inequity of the WEP, Dr. Robert J. Meyers, former Chief Actuary of the Social Security Administration, has proposed that the percentage in the "guarantee" be reduced from 50% to 20%. The "guarantee" is that the reduction in benefits resulting from applying the WEP formula can be no more than 50% of the government annuity. This only helps people with extremely small government pensions. Social Security estimates that 90,000 government retirees would see an increase in their benefits under Dr. Meyers' proposal.

In summary, the GPO and WEP has had a devastating effect on the retirement incomes of many federal, state and local government retirees. It is hoped, Mr. Chairman, that your Subcommittee will seriously consider changes to the GPO and WEP provisions of the Social Security Act to provide a more equitable solution.

#### **Coalition to Assure Retirement Equity Members**

American Federation of Government Employees	National Association of Letter Carriers
American Federation of State, County, and Municipal Employees	National Association of Police Organizations
American Federation of Teachers	National Association of Postal Supervisors
American Foreign Service Association	National Association of Postmasters of the U.S.
American Postal Workers Union	National Association of Retired Federal Employees
Employees For Full Offset Repeal Today (Denver, Co.)	National Committee to Preserve Social Security and Medicare
Federally Employed Women	National Council of Senior Citizens
Federal Managers Association	National Council on Teacher Retirement
Gray Panthers	National Education Association
Illinois Retired Teachers Association	National Federation of Federal Employees
International Association of Fire Fighters	National League of Postmasters
International Federation of Professional and Technical Engineers	National Rural Letter Carriers Association
International Union of Electronic, Electrical, Salaried, Machine & Furniture Workers	National Treasury Employees Union
Louisiana Retired State Employee's Association	Older Women's League
Mailhandlers Div. of Laborers' International Union of North America	Patent Office Professional Association
Massachusetts Pension Not Posies Coalition	Professional Managers Association
National Air Traffic Controllers Association	Public Employee Department—AFL—CIO
National Association of Air Traffic Specialists	Retired State, County and Municipal Employees Association of Massachusetts
National Association of Governmental Employees	School Employee Retirees of Ohio, Inc.
	Senior Executives Association
	Social Security Managers Association
	Women's Institute For A Secure Retirement

Chairman BUNNING. Thank you very much.  
Ms. Jernigan.

**STATEMENT OF BERNADINE A. JERNIGAN, CHAPTER MEMBER,  
NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES**

Ms. JERNIGAN. Mr. Chairman, Members of the Subcommittee, my name is Bernadine Jernigan. I'm a member of the Vienna, Virginia, Chapter of the National Association of Retired Federal Employees. I'm 73 years old and have worked both for the Federal Government and in the private sector. I am currently—

Chairman BUNNING. Pardon me, Ms. Jernigan, would you please pull that right up to you, so we can all hear a little better? Thank you.

Ms. JERNIGAN. I am currently employed 2 days a week as a secretary/receptionist in a small business firm. I first started working in the private sector in 1943. In 1946, at the end of World War II, I married a marine. Military families transfer every few years making it difficult for wives to develop a long-term career. Also, my generation of women were professional homemakers, not usually a high salaried position.

Despite these complications, while raising my family, I earned the quarters needed to become eligible for Social Security benefits at age 62. My husband served in Korea and when that conflict ended he returned home and was hired by the Central Intelligence Agency. We were stationed overseas several times during the next 15 years, and when 3 of our 5 children were in college at the same time I went to work to help pay the college expenses. At that time, I was 49 years old and found it difficult to find a good paying position in my previous profession. I was hired by the CIA, but it was at a lower paid GS position.

After working 13 years, I retired under the Civil Service Retirement System. My husband had also retired, and he went to work in the private sector. At age 65, he began receiving his full Social Security benefits. At age 62, I filed for my own Social Security benefits, but continued to work in my 2 day a week job continuing to pay into the Social Security system. The Social Security office told me that I would receive a check for \$152 a month, but my first check was for \$32. I had been hit by the windfall elimination provision and took an initial deduction because of being age 62. All together, I lost almost 75 percent of my benefits.

My husband died in 1993, and the government pension offset stepped in and reduced my already reduced benefits—I'm sorry. Instead of receiving full widows benefits, I receive about one-third of that amount because of my years as a government employee. No one in the private sector has two-thirds of his pension taken away.

Current government employees who retire under the new Federal Employees Retirement System, FERS, are not affected by the GPO. I could have also been exempt, but I was never informed that if I had worked three more weeks I could have transferred to FERS and been exempt from the GPO. I continue to work at age 73 and have approximately \$50 in Social Security taxes withheld from my

pay each and every month. I have been told I will never see this money, but I must continue to pay it.

GPO and government pension offset and windfall elimination are laws that discriminate against some government employees. Those of us affected by these unjust laws are not asking for benefits we have not paid for or earned. We ask that the system be made fair. Why are some, especially widows, less entitled than others. We simply ask that these two laws be repealed. Each time I receive a cost-of-living adjustment in my small annuity, my Social Security benefits are reduced. It's not easy to live on income below the national poverty level.

In 1997, I received a letter from the Social Security Administration claiming that they had overpaid me \$600. My requests for clarification were ignored, and they just refused to answer my questions. A visit to the local Social Security office ended in a confrontation when the clerk accused me of being responsible for the overpayment, and it was all my fault, and she ushered me out the back door.

After nearly 30 years of working and paying into Social Security, I receive \$156. This is after the deductions of \$43.80 for Medicare, \$16 for the overpayment, and a \$280 offset. Without windfall and government pension offset, I should be receiving close to \$500 in widows benefits. It's excruciatingly painful to suffer the loss of \$280 of my promised benefits each and every month of my life.

Why are government employees being punished? Where is the fairness in these two pieces of legislation? Why must we continue to fight for the benefits we were promised and have already paid for? Are we going to our graves fighting these discriminations? Thank you.

[The prepared statement follows:]

**Statement of Bernadine A. Jernigan, Chapter Member, National Association of Retired Federal Employees**

My name is Bernadine A. Jernigan and I am a member of the Vienna, Virginia chapter of the National Association of Retired Federal Employees. I am 73 years old and have worked both for the federal government and in the private sector. I am currently employed two days a week as a secretary/receptionist in a small business firm.

I first started working for the federal government in 1943. In 1946, at the end of World War II, I married a marine. Military families transfer every few years making it difficult for wives to develop a long-term career. Also, my generation of women were professional homemakers, not usually a high-salaried position. Despite these complications, while raising my family, I earned the quarters needed to become eligible for Social Security benefits at age 62.

My husband served in Korea and when that conflict ended he returned home and was hired by the Central Intelligence Agency (CIA). We were stationed overseas several times during the next fifteen years. When three of our five children were in college at the same time I went to work to help pay the college expenses. At that time I was 49 years old and found it difficult to find a good paying job in my previous profession.

I was hired by the CIA but it was in a lower paid GS position. After working thirteen years I retired under the Civil Service Retirement System. My husband had also retired and he went to work in the private sector. At age 65 he began receiving his full Social Security benefits.

At age 62 I filed for my own Social Security benefits but continued to work in my two day a week job, continuing to pay into the Social Security system. The Social Security office told me that I would receive \$152 a month but my first check was for only \$39. I had been hit by the Windfall Elimination Provision (WEP), and took an additional reduction because of being age 62. Altogether I lost almost 75% of my benefits.

My husband died in 1993 and the Government Pension Offset (GPO) stepped in and reduced my already reduced benefits. Instead of receiving a full widow's benefit, I receive about one-third of that amount because of my years as a government employee. No one in the private sector has two-thirds of his pension taken away. Current government employees who retire under the new Federal Employees Retirement System (FERS) are not affected by GPO. I could have been exempt also but I was never informed that if I had worked three more weeks I could have transferred to FERS and been exempt from the GPO.

I am continuing to work at age 73 and have approximately \$50 in Social Security taxes withheld from my pay each and every month. I have been told I will never see this money again but I must continue to pay it.

GPO and WEP are laws that discriminate against some government employees. Those of us affected by these unjust laws are not asking for benefits we have not paid for or earned. We ask that the system be made fair. Why are some (especially widows) less entitled than others? We simply ask that these two laws be repealed. Each time I receive a cost-of-living adjustment in my small annuity my Social Security benefits are reduced. It is not easy to live on an income below the national poverty level.

In 1997 I received a letter from the Social Security Administration claiming that they had overpaid me \$600. My requests for clarification were ignored and they just refused to answer my questions. A visit to the local Social Security office ended in a confrontation when the clerk accused me of being responsible for the overpayment, that it was all my fault.

After nearly 30 years of working and paying into Social Security I receive only \$156. Without WEP and GPO I should be receiving about \$500 in widow's benefits. It is excruciatingly painful to suffer the loss of \$350 of my promised benefits each and every month of my life.

Why are government employees being punished? Where is the fairness in this WEP and GPO legislation? Why must we continue to fight for the benefits we were promised and have already paid for? Are we going to our graves fighting this discrimination?

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Chairman BUNNING. Thank you for your testimony.  
Mr. Rugola.

**STATEMENT OF JOSEPH RUGOLA, INTERNATIONAL VICE PRESIDENT, AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES (AFSCME); AND EXECUTIVE DIRECTOR, LOCAL 4, OHIO ASSOCIATION OF PUBLIC SCHOOL EMPLOYEES (OAPSE)**

Mr. RUGOLA. Mr. Chairman and Members of the Subcommittee, I'm Joseph Rugola, international vice president of the American Federation of State, County, and Municipal Employees and Executive Director of the Ohio Association of Public School Employees, OAPSE, Local 4 of AFSCME.

I appreciate the opportunity to be here today to share our experiences with the government pension offset, a Federal law that's had a devastating affect on thousands of our members. I would also like to express AFSCME's opposition to mandatory Social Security coverage for public employees who do not currently participate in the system. In the interest of time, I will submit my written testimony which includes further information in opposition to mandatory Social Security coverage.

My local union known as OAPSE represents nearly 40,000 workers in school districts throughout Ohio. Ohio is a State that does not participate in Social Security for its public employees. Our OAPSE members are covered instead under SERS, the Ohio School Employees Retirement System, which is a defined benefit pension

plan. While our members can't receive Social Security benefits based on their earnings in public service, they can receive benefits as the spouse or widow of a Social Security covered worker. Unfortunately, the government pension offset demands that they reduce these Social Security benefits by two-thirds of the amount of the public pension.

Currently, the average SERS pension is less than \$500 a month. These relatively low pensions reflect the lower paying job categories and work patterns of school district employees who are predominantly women. Our members are school cafeteria workers, crossing guards, bus drivers, custodians, classroom aids, and secretaries. Many retire after a full-length career as school district employees, but they may have worked only a 30-hour week, a pattern we call "short hours." Others may have had less than a full career, say 15 or 20 years in their school district following divorce or child rearing. Most of these women began their careers expecting to retire with both a public pension and a Social Security spouse benefit. It's a shock when they realize that they will not receive a much needed portion of their expected retirement income.

We recognize that private sector workers cannot receive full Social Security benefits from their own work plus full benefits from a spouse. This rule for dually eligible Social Security beneficiaries is supposed to be the basis for the GPO, but the situations really are not comparable. To start with, school district employers in Ohio contribute 13.5 percent of payroll to SERS. The worker share is more than 8 percent. The total of these contributions, 21.5 percent, is nearly double the combined employer-employee contribution under Social Security. These rates are typical for public pensions in non-Social Security jurisdictions.

The GPO law assumes that the public plan contributions that exceed Social Security rates are the equivalent of contributions to a private pension plan. This reasoning precipitated the 1983 offset revision which reduced the original 100-percent offset to the current two-thirds, but even the two-thirds calculation is very imprecise and not very fair.

Consider the fact that most private pension plans do not require any contributions from any workers. They're financed completely by the employer. Nevertheless, when the workers retire, they get their full pension benefit plus their full Social Security benefit with no offset of any kind. Meanwhile, our members pay on both the front and the back end. To make matters worse, their entire pension benefit is subject to Federal income taxes while Social Security benefits are tax free for most retirees.

To see how much the GPO can hurt, take a look at two of the members of our retiree organization. Due to time limitations they will have to represent the many, many calls and letters that OAPSE regularly receives from GPO victims. Take Shirley Milburn of Windsor, Ohio, for example. Her SERS pension check is \$405 a month. Her husband's monthly Social Security benefit is \$786 a month. Normally, she could expect to receive a spousal benefit equal to half his benefit or \$393 a month. Instead, the GPO reduces it to only \$121 a month giving her a total retirement benefit, pension plus Social Security, of only \$526 a month, and from that amount she must still deduct her Medicare part B premium of \$43.

Another example is Donna Stevenson, an OAPSE member who retired to Lake Park, Georgia. Her SERS pension is \$534 a month, and her husband receives \$827 a month from Social Security. Instead of getting a spousal benefit of \$413, Donna's benefit from Social Security is only \$55 a month. When she deducts her Medicare premium, she's left with a monthly check of \$12.

When the GPO was first enacted, it was meant to target people receiving multiple government pensions, some of whom had higher incomes in retirement than they had while working. Our members just don't fit the image of these so-called double and triple dippers. Congress could not have had them in mind when the GPO was passed. That's why AFSCME strongly supports H.R. 2273, the GPO reform bill, sponsored by Congressman Jefferson.

The Jefferson bill would permit the public pensioners who were not covered by Social Security to keep as much as \$1,200 a month in combined pensions and Social Security spousal widow's benefits before the two-thirds offset is imposed. We believe this will protect thousands of low-pension women who badly need their Social Security benefits to keep them out of poverty. It's a targeted approach to GPO reform, and it makes good sense.

If H.R. 2273 were in effect today, Shirley Milburn would be a lot better off. She could keep her SERS pension check of \$405 a month plus her entire Social Security spouse benefit. This would give her a combined monthly benefit of \$798. Donna Stevenson would be in much better shape too.

We urge the Members of the Subcommittee to give careful consideration to H.R. 2273. Shirley and Donna and thousands more like them are counting on your support. Thank you, Mr. Chairman.

[The prepared statement follows:]

**Statement of Joseph Rugola, International Vice President, American Federation of State, County, and Municipal Employees (AFSCME); and Executive Director, Local 4, Ohio Association of Public School Employees (OAPSE)**

Good morning, Mr. Chairman and Members of the Subcommittee. I am Joseph Rugola, International Vice President of the American Federation of State, County and Municipal Employees (AFSCME) and Executive Director of AFSCME Local 4—the Ohio Association of Public School Employees (OAPSE). I appreciate the opportunity to be here today in order to express AFSCME's opposition to mandatory Social Security coverage for public employees who do not currently participate in the system. We would also like to share our experiences with the Government Pension Offset (GPO), a federal law that has had a devastating effect on so many of our members.

My local union, known as "OAPSE," represents nearly 40,000 workers in school districts throughout Ohio. Ohio is a state that does not participate in Social Security for its public employees. Our OAPSE members are covered, instead, under SERS—Ohio's School Employees Retirement System—which is a defined benefit pension plan.

While our members can't receive Social Security benefits based on their earnings in public service, they can receive benefits as the spouse or widow of a Social Security-covered worker. Unfortunately, the Government Pension Offset demands that they reduce these Social Security benefits by two-thirds of the amount of their public pension.

Currently, the average SERS pension is less than \$500 a month. These relatively low pensions reflect the lower-paying job categories and work patterns of school district employees, who are predominantly women. Our members are school cafeteria workers, crossing guards, bus drivers and custodians. Many retire after a full-length career as school district employees, but they may have worked only a 30-hour week—a pattern we call "short-hours." Others may have had less than a full career—say 15 or 20 years in their school district following divorce or child rearing.

Most of these women began their careers expecting to retire with both a public pension and a Social Security spouse benefit. Its a shock when they realize that they will not receive a much-needed portion of their expected retirement income.

We recognize that private-sector workers cannot receive full Social Security benefits from their own work plus full benefits from a spouse. This rule for dually-eligible Social Security beneficiaries is supposed to be the basis for the GPO. But the situations really are not comparable. To start, school district employers in Ohio contribute 13.5 percent of payroll to SERS. The workers share is more than 8 percent. The total of these contributions—21.5 percent—is nearly double the combined employer-employee contribution under Social Security. These rates are typical for public pensions in non-Social Security jurisdictions.

The GPO law assumes that the public-plan contributions that exceed Social Security rates are the equivalent of contributions to a private pension plan. This reasoning precipitated the 1983 offset revision, which reduced the original 100 percent offset to the current two-thirds. But even the two-thirds calculation is very imprecise and not very fair.

Consider the fact that most private pension plans do not require any contributions from workers. Theyre financed completely by the employer. Nevertheless, when the workers retire they get their full pension benefit plus their full Social Security benefit, with no offset of any kind. Meanwhile, our members pay on both the front and back ends. To make matters worse, their entire pension benefit is subject to federal income taxes, while Social Security benefits are tax-free for most retirees.

To see how much the GPO can hurt, take a look at two of the members of our retiree organization. Due to time limitations, they will have to represent the many, many calls and letters that OAPSE regularly receives from GPO victims.

Take Shirley Milburn of Windsor, Ohio, for example. Her SERS pension check is \$405 a month. Her husbands monthly Social Security benefit is \$786.30. Normally, she could expect to receive a spousal benefit equal to half his benefit, or \$393.15. Instead, the GPO reduces it to only \$121.80, giving her a total retirement benefit—pension plus Social Security—of only \$526.80 a month. And from that amount, she must still deduct her Medicare Part B premium of \$43.80.

Another example is Donna Stevenson, an OAPSE member who retired to Lake Park, Georgia. Her SERS pension is \$534.39 a month and her husband receives \$827.60 a month from Social Security. Instead of getting a spousal benefit of \$413.80, Donnas benefit from Social Security is only \$55.80. When she deducts her Medicare premium, shes left with a monthly check of only \$12.

Its my understanding that when the GPO was first enacted, it was meant to target people receiving multiple government pensions, some of whom had higher incomes in retirement than they had while working. Our members just dont fit the image of these so-called “double and triple dippers.” Clearly, Congress did not have them in mind when the GPO was passed.

Thats why AFSCME strongly supports H.R. 2273, the GPO reform bill sponsored by Louisiana Congressman William Jefferson. The Jefferson bill would permit public pensioners who were not covered by Social Security to keep as much as \$1,200 a month in combined pension and Social Security spouse or widows benefits before the two-thirds offset is imposed. We believe this will protect thousands of low-pension women who badly need their Social Security benefits to keep them out of poverty. Its a targeted approach to GPO reform and it makes good sense.

If H.R. 2273 were in effect today, Shirley Milburn would be a lot better off. She could keep her SERS pension check of \$405.00 a month, plus her entire Social Security spouse benefit of \$393.15. This would give her a combined monthly benefit of \$798.15—well within the bills \$1,200 limit.

Donna Stevenson would also be in much better shape. Shed receive a total monthly benefit of \$948.19 and could put a few of her financial worries to rest.

We urge the Members of the Social Security Subcommittee to give careful consideration to H.R. 2273. Shirley and Donna—and thousands more like them—desperately need your support.

Just as we oppose the punishing effects of the Government Pension Offset, AFSCME opposes any action to mandate Social Security participation for state or local governments that do not currently provide Social Security coverage to their public employees. Nearly 25 percent of public employees are not covered by Social Security. About the same percentage of AFSCME members are in this category. But these individuals do not lack pension protection. Nearly all are covered by state or local defined benefit pension plans.

Furthermore, the Omnibus Budget Reconciliation Act (OBRA) of 1990 has already ensured that any temporary, part-time or seasonal employee not covered by one of these public plans be covered under Social Security. So, already there is basic pen-

sion protection for all American workers—private and public-sector. There is no need to mandate Social Security coverage in an effort to protect workers interests.

Public employees and their employers have been given ample opportunity to come under Social Security. Most have voluntarily done so. Those still outside the system clearly prefer their own state or local pension plans. The vast majority of these plans are healthy and actuarially sound. Most of them have been in existence longer than Social Security and were designed to function without it. They have excellent records for providing disability protection and retirement security to their participants.

Mandated Social Security coverage could have serious implications for public employees, their employers, and their pension plans, even if the coverage applies only to future hires.

Employees (i.e., future hires) would be required to pay 6.2 percent of their paychecks in FICA tax, even though most are already making substantial contributions to their public employee pension plans. Unlike the private sector—where plans are usually financed entirely by employers—contributions by public workers in non-Social Security jurisdictions typically range from 8 to 10 percent of pay. Adding the Social Security payroll tax would create an unaffordable burden for millions of these workers, most of whom have lower-to middle-incomes.

Employers would also be required to contribute 6.2 percent of payroll to Social Security, on top of the contributions they now make to fund their own pension plans (typically 13 to 15 percent of payroll). Many of the states most affected, such as California and Massachusetts, have only recently pulled themselves out of deep fiscal crises and simply cannot afford to meet this new expenditure. If forced to do so, the result could be a loss of jobs and public services.

Faced with a requirement to pay the Social Security payroll tax on behalf of employees, governments would most likely try to create new pension plan tiers for new hires that would integrate Social Security with supplemental public pensions. This could result in reduced benefits, increased employee contributions and changes in retirement ages. Benefit structures for future retirees could be drastically altered.

It could also destabilize public pension funds for today's workers and retirees. Benefits in existing public pension plans rely heavily on a funds investment earnings. If some of these investments are cut off and the proceeds diverted to new plans, it could spell serious trouble for AFSCME members and other public employees.

The result could be the inability of pension plans to pay promised benefits to current participants, unless taxes are raised to fund much higher employer contributions. In addition to reductions in basic benefits, plans would be forced to look seriously at other types of cuts—in already small cost-of-living adjustments or retiree health care coverage, for example.

AFSCME believes that mandatory coverage would create havoc for public retirees, while providing only limited relief for Social Security. After all, an influx of new funds might help with a quick fix, but eventually the new participants will be eligible to collect benefits. At that point, they might create new problems for Social Security.

In closing, we would like to emphasize AFSCME's strong support for strengthening Social Security—our nation's great system of income protection that touches the lives of most American workers, including 75 percent of AFSCME members.

AFSCME opposition to mandatory coverage is not based on a belief that Social Security doesn't work. We think it does a remarkable job of providing basic security and shielding participants from potential poverty. Rather, we oppose mandatory coverage because it will cause serious problems for a group of workers and retirees who have never been part of that system.

For the majority who do participate in Social Security, we advocate maintaining the system's current social insurance structure, while making the moderate changes necessary to ensure the system's long-term solvency.

Thank you.

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Chairman BUNNING. Thank you very much for your testimony. Ms. Jernigan, thank you for being here and sharing your story with us. I am very sorry to hear of your experience at the Social Security office. I wish some representatives of Social Security were here—I don't think they are—so they could—we hear those stories quite frequently. In fact, I would say 75 percent of all calls to my office in my district are on Social Security problems, and so it is



not an unusual occurrence. To be ushered out the back door might be an unusual occurrence. We understand your frustration, and we want to do something about it. I don't know if Mr. Jefferson's bill is the exact way to do it, but it would be a start in the right direction.

Let me ask Mr. Normandie, you indicated that CARE has supported Congressman Jefferson's proposal that would eliminate the government pension offset and the \$1,200 threshold would be—anything less that, they could get to the \$1,200 threshold. You also mentioned Congressman Frank's bill on the windfall elimination provision and a separate proposal by Dr. Robert Myer. Does CARE support either the Frank bill or the Myer proposal?

Mr. NORMANDIE. CARE doesn't really have a position on the Frank bill, because we were formed as a coalition for the government pension offset, and we really haven't developed a policy yet on that or on Dr. Myers' proposal.

Chairman BUNNING. Joseph, you mentioned that you also support 2273, because it would protect thousands of low-pension women who need their benefits to keep them out of poverty. Are you saying that the overall policy, it makes better sense to target the government pension offset as opposed to rebuilding it all together?

Mr. RUGOLA. Our goal, when we began the debate years ago, Mr. Chairman, was to have the GPO reversed. It's our opinion—

Chairman BUNNING. Completely eliminated.

Mr. RUGOLA. Completely eliminated. But the fact of the matter is that in the 20 years I've been with OAPSE, for me, this issue's become as much of a women's poverty question as it is a retirement or pension question. We just have thousands of people who are at or near the poverty line, and our objective ought to be, we think, to take care of that problem first. I think the GPO is unfair. I pay into Social Security. I'm looking forward to drawing my benefit. I'm also going to be the recipient of a private pension plan. I don't have an offset.

I think the GPO is unfair, and it ought to be repealed, but the fact of the matter is that the real tragedy is for the overwhelming number of women. Of our members, we calculate about 70 percent of them at some point will be affected by the GPO, and since our membership is almost 70 percent women, we're talking about tens of thousands of women who really will be at the edge of poverty or in poverty during retirement. The cap in Congressman Jefferson's bill, we think, is a reasonable place to begin work on this: It at least alleviates the poverty aspect of the GPO.

Chairman BUNNING. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman, and I appreciate the testimony on both the issues. I have one general question that I just thought of as you were responding to Mr. Bunning. One of the unfairness aspects of this is the fact that with private pension savings there's no offset. I don't know what your private pension is—are you in a 457 plan or 403 plan?

Mr. RUGOLA. We're in a defined benefit pension plan which falls under neither one of those categories, actually, but our—

Mr. PORTMAN. It's a public sector—

Mr. RUGOLA. No, the plan under which I will draw a benefit is a private pension plan.

Mr. PORTMAN. OK.

Mr. RUGOLA. Our members are covered, of course, under the School Employee Retirement System which is a defined benefit public plan.

Mr. PORTMAN. OK. I guess my question is you've made the analogy, really, between the two and drawn the unfairness argument out of that saying that if you are in a private plan you don't have an offset. If you're in a government plan you do have an offset. There also are, of course, options for government employees to get into private plans like the 457 plan; not a private plan but a defined contribution plan or a 403(b) plan, and, as you know, I've got legislation to greatly expand that and to be able to permit roll-overs—and I'll make a pitch for my legislation here. Actually, it will help this situation.

Chairman BUNNING. Rob, there's nobody here listening to—

Mr. PORTMAN. OK, nobody's listening?

Chairman BUNNING. You have to sell it to the rest of the Subcommittee.

Mr. PORTMAN. I got to get you and Mac on it, but it's actually helps in this situation because it will give government employees a lot more options in terms of providing for their retirement savings without having to worry about all this. Is that correct? In other words, the 457 plans, 403(b) plans would not result in any kind of offset.

Mr. RUGOLA. Right, that portion of it. That's my understanding of how it would work, but, you know, the point you're making, Congressman, is an excellent one in terms of how the income aspect of this, the poverty aspect of this plays out. Our average salary in our union for active workers is just over \$15,000 a year. Even for our full-time workers who are mostly women—secretaries and classroom aids in the schools—the average salary is barely over \$20,000 a year.

The question will be how much of their—particularly, those who are trying to raise a family on their own—how much of their income will be able to be devoted to a private pension plan? They really suffer on both ends. They wouldn't be able to take advantage of the kind of options that you're talking about, because the disposable income question comes into play, and then when they do retire, if they're affected by the offset, they're penalized at that point during retirement.

Mr. PORTMAN. I understand that it would be difficult for some people, particularly young families, to put that money aside. I also think it's in their interest, particularly if we can get this legislation passed, because you have more options in terms of rollover; more options in terms of buying service credits with those assets out of those plans that you want to, and, of course, we raise the contributions and allow the plans just to be more of a backstop to the Social Security and the State retirement plans. So, I understand what you're saying, though, there still will be a group of people who are unlikely to take advantage of that. I think more education is necessary on both fronts.

Let me ask you another question with regard to the fairness issue, and, again, understanding this is a \$5 billion question, I think, with regard to the repeal; \$5.5 billion, I guess, with regard to the windfall elimination. Is there more education that could take place? You've all essentially said people are shocked when they find out this is true. Are we doing a good enough job, and are the State plans doing a good enough job to explain to people the situations so that there is at least more planning and less of that shock?

Mr. RUGOLA. The answer to that question, I think, is that the State plans are doing everything that they can. I think there's a limit to how much people can do to prepare themselves for the effect of the GPO when they're already low-income workers. The fact of the matter is as we've heard earlier today from a couple of other witnesses, what our folks are asking for here is not a benefit that hasn't been earned. Most of the widows, most of the women affected by the GPO are the spouses of men who worked, and under any circumstances would be entitled to half of that Social Security benefit. So, I think it's problematic in that regard. Our people know, believe me. I'm not a pension expert, but I'm more of an expert than I want to be on the misery that's been caused by the GPO, because I have to face too many people everyday and explain to them what the effect of this is going to be on their retirement security.

Mr. PORTMAN. Has your group, the international group, spent some time looking at how we could target something like H.R. 2273 to the situation that you talk about; not just to women although you mentioned low-income, fixed-income widows is where you see most of that misery you talk about, but is there a way to come up with some income targets in a context like this more general legislation, H.R. 2273, that you all have looked at?

Mr. RUGOLA. To my knowledge, the cap itself is really the only rational and effective way to deal with it. It's a \$1,200 limit which, I might add since you asked Congressman, it's kind of interesting because I was here testifying a few years ago on the offset. I had a side conversation with Congressman Kasich and he suggested that there might be a lot more understanding if there were a cap involved because Congress when it passed the GPO, in the first place, it was aimed at these huge pensioners who were double and triple dippers. His point to me was folks would understand a lot more readily what you're trying to get at which is the poverty question.

Mr. PORTMAN. If we could target them more.

Mr. RUGOLA. If it was targeted at lower income.

Mr. PORTMAN. And getting it done in the context of Social Security reform.

Mr. RUGOLA. Yes. We don't know of any better way to do it than the income cap that's in Congressman Jefferson's bill.

Mr. PORTMAN. Thank you, Mr. Chairman.

Chairman BUNNING. Thank you.

Mr. Collins.

Mr. COLLINS. Just one brief question, Mr. Chairman. Going back to the question we asked Mr. Scott about portability. If a person retires from a government job under the government retirement program and is not entered into the Social Security system, and

then they go to work in the private sector and come under the Social Security guidelines, would it be feasible for the government retirement program to be portable whereby any deduction that would be the same or equal to Social Security, instead of being deposited to the Social Security account for that individual, is then deposited directly to the same retirement account but the worker would not be eligible until he or she retired from the second job.

Mr. RUGOLA. Congressman Collins, now you're getting into some technical areas of retirement that I'm just not well-versed enough on to answer, and I'm reluctant to get into those kind of discussions, because it takes a retirement system person to answer that question, and I'm a union person, not a retirement system person.

Mr. COLLINS. Well, the money follows the person, and it goes into the same retirement account only they would not be eligible for the increased benefit until such time as eligible for retirement again.

Mr. RUGOLA. I understand the concept you're describing. In your question, you use the word "feasibility," and that part of it is—the feasibility aspect is something that—

Mr. COLLINS. How would that affect the offset and such?

Mr. RUGOLA. I think the offset—

Mr. COLLINS. Do you think we'd have just one retirement system? One retirement plan for that individual, no matter if it was public or private, one retirement plan for all of us.

Mr. RUGOLA. Well, on the question of whether public employees ought to be mandated into the system, we're opposed to that for a number of reasons.

Mr. COLLINS. Yes, but once they retire from the public and go into the private sector for employment, then they have to come under the Social Security.

Mr. RUGOLA. They do if they qualify.

Mr. COLLINS. So, if Social Security deductions and matching by the employer normally being directed to the Social Security Trust Fund were directed instead to that same retirement program they are already participating in and drawing benefits from, and as long as the benefits wouldn't change until the time they became eligible for retirement again they wouldn't be double dipping or wouldn't have two retirement systems; they'd still have just one.

Mr. RUGOLA. If I understand your question correctly, what's problematic is the objective. First of all, many of our people who are covered by SERS, by our public plan, have either come late in their career to the public schools or they were employed previously in the private sector and then have come to public sector work. I'm not sure about the feasibility of post-public sector careers in that—

Mr. COLLINS. You would be in a prospective basis. It would not be retroactive to anyone; it would be prospective.

Mr. RUGOLA. Right, I understand that piece of it, as I said. I'm just not—

Mr. COLLINS. I just thought I throw it out for discussion. Thank you, Mr. Chairman.

Chairman BUNNING. I want to thank the panel. Often, it's impossible for us, on the Subcommittee, to cover every issue that we are interested in during the hearing. Therefore, we may submit additional questions in writing for you to answer for the record. I would

like to thank all of our witnesses for your extensive and thoughtful testimony. I have learned and I think the panel has learned a great deal today on things that we have dealt with.

Chairman BUNNING. The Subcommittee stands adjourned.

[Whereupon, at 12:35 p.m., the hearing was adjourned subject to the call of the Chair.]

[Submissions for the record follow:]

**Statement of Donald L. Novey, President, California Correctional Peace Officers Association**

**Should Social Security be expanded to cover all newly hired state and local employees?**

My name is Don Novey. I am the president of the California Correctional Peace Officers Association which represents 27,000 state employees who work the toughest beat in California. I suppose you could characterize these dedicated men and women as working class, but their work is in a class of its own.

Their noble function in our society is extraordinary; the sacrifices they routinely make carrying out their duties—sacrifices that are sometimes taken for granted—are a portrait of their courage, commitment to service, and professionalism. I am proud to be associated with these special Americans who put their lives on the line every day they go to work.

Let me briefly describe the conditions correctional officers commonly face at work. They are routinely “gassed” by inmates throwing urine and feces. They are exposed to life-threatening diseases like tuberculosis, hepatitis, and AIDS. They are often assaulted with deadly handmade weapons. In fact, in California alone, correctional officers endure about 1,500 assaults each year. Sometimes these attacks are fatal. Everyday—24 hours a day—they “walk the line,” armed only with a side-handle baton, among some of the toughest, most violent inmates in the world.

The stress behind prison walls is suffocating and unrelenting. Only about one in five felony convictions in California actually results in prison time which means that only the worst of the worst are sent to state prison. Thus unlike other law enforcement professionals, correctional peace officers face the state’s most violent criminals all day every working day. A reporter who toured Folsom Prison wrote: “There is no denying a palpable tension suffuses the atmosphere. The idea of spending a half-hour here seems unpleasant; the specter of years seems unbearable.”

To magnify the “palpable tension,” prisons in California are operating at an alarming 201% capacity, holding over twice the number of inmates for which they were designed. At the same time that our prison population is exploding, budget cuts and staff shortages are reducing the ratio of officers to inmates to dangerously low levels.

With this background, I would now like to turn to the issue at hand. I am perplexed and disappointed by the proposal to include all currently uncovered newly hired state and local employees in Social Security. I also must question the findings of the Report of the Advisory Council on Social Security, which report has been given significant consideration by this subcommittee.

The council’s report, which is two volumes and 750 pages, devotes roughly one-half page to this issue. Given my perspective of the issue and the many questions that were apparently not discussed, I can come to only one conclusion: that the Advisory Council’s recommendation to expand Social Security to include newly hired state and local employees has not been given sufficient thought.

Consequently, I want to commend and to thank Chairman Bunning for devoting an entire hearing to focus on this troubling proposal. I believe that after careful consideration, level heads will prevail and most of us will agree that burdening correctional officers, police, and other hard-working, essential public servants would be enormously unfair.

In the report’s brief half-page coverage of this issue, three potential flaws are suggested. First, bringing state and local employees into Social Security may raise Constitutional issues. Secondly, while there may be a short-term influx of revenue, it is questionable whether or not it would sustain sufficient benefits to be paid out in the future. Finally, the added financial burden on workers and taxpayer-funded, public employers already contributing to public pension systems would be unjust. We strongly concur with these concerns and I will expound on them throughout the course of my remarks.

At this point, we would like to respond to what appears to be the only argument offered in the council's report in favor of expanding Social Security to state and local employees. The report states that it is a question of fairness. We completely agree that it is a question of fairness, but we emphatically disagree with the report's apparent conclusion that the current system is unfair to other working Americans who contribute to Social Security. Let's examine the question of fairness.

Is it fair to raid the paychecks of devoted public servants who already make tremendous personal sacrifices, whose stressful occupations place extreme demands upon them while they are notoriously underpaid? Is it fair to impose a double tax on the families of public safety officers and other state employees? Because states have limited and defined budgets, the "employers' portion of the Social Security tax would be paid by the state from its payroll funding which means the employees' tax as well as the matching employers' contribution would be paid from a single source.

Is it fair to destroy well-established, highly effective retirement systems that are designed, under an existing set of rules, to accommodate the specific needs of state and local employees? On the basis of this issue alone, three members of the Advisory Council opposed the "inclusion of currently uncovered state and local employees because of the financial burden that would be placed on workers and employers who are already contributing to other public pension systems." The fact is, the new tax would be more than a "financial burden." It would result in an immediate deterioration of state employees' existing retirement systems. Additionally, it would remove an enormous infusion of contributions into private investments which would be damaging to the economy in general.

Is it fair to punish the working class, many of whom can least afford it, to pay for over forty-years of irresponsible fiscal policies of the federal government? The state and local governments and especially their dedicated employees did not create the financial mess Social Security is now facing. We should not have to pay for it.

Is it fair to impose a new payroll tax on states and counties which would inevitably result in cuts to or the elimination of important programs as well as a reduction in already dangerously thin staffing levels for correctional facilities? Is it fair or wise to add to the extreme danger levels and unrelenting job-related stress of correctional officers and our police by taking urgently needed funds for training, safety equipment, technological advancements and sending the money to Washington?

Is it fair or wise to place side by side two young correctional officers, one a "newly hired," who are required to perform the same duties, face equal risks, make comparable sacrifices, but who receive different benefits. It may not have an impact at first, but as the years pass and resentment builds, compounded by the daily tension and stress that comes with the job, loyalty may weaken or professionalism may be compromised. Worst case, in an instant these two officers could be faced with a life and death decision. At best, this situation would damage morale in an environment that can ill afford such an atmosphere.

Can any of us honestly and sincerely answer any of these questions "yes?" I seriously doubt it. So if, as the council's report suggests, the proposal is simply a question of fairness, let us answer it now. Clearly it is not fair to mandatorily cover all newly hired state and local employees. Still, we can take the question of fairness a step further. Let us review it from the perspective of all other workers who are paying into Social Security.

Who in our society have chosen to be correctional or police officers? These are high-stress, dangerous, underpaid jobs that most citizens will not do. Yet they want it done; they expect it to be done; and they expect it to be done professionally by qualified, well-trained, highly-skilled individuals. They want emergency services readily available. They want their police to be well equipped. At a time of need, they want their fire-fighters at their door in an instant. They also want computers in their children's classrooms, the best teachers, and a wide range of educational and extracurricular activities and programs.

Is it reasonable to believe that private sector employees would begrudge a small percentage of underpaid, overworked public servants having their own retirement system? Would these same citizens answer "yes" to the fairness issue questions cited above? I strongly believe that they would NOT on both counts. Furthermore, I firmly suggest that Americans paying into Social Security who are given the perspective of all sides of the issue would gratefully acknowledge the sacrifices of the devoted, conscientious, hard-working public servants who are now being targeted for this onerous tax.

Perhaps, instead of an issue of "fairness," the true reason for proposing an expansion of Social Security to newly hired state and local employees is because it seems an easy fix to bolster the long-term projections for Social Security. The intensity and political nature of the larger debate over Social Security should not tempt us to make this particular change without reviewing it on its own merits.

Ironically, this quick fix may backfire. *It is quite possible that Social Security will lose money by forcing public safety officers into the system.* First of all, public safety officers retire at a younger age—and for good reason. In consequence of the intense nature of their employment as well as the obvious occupational hazards, public safety officers commonly retire between the ages of fifty and fifty-five. In addition, public safety officers are not protected by age discrimination. They can be forced into retirement at age fifty-five. The state benefits operationally by having a younger, healthier work force. Consequently, many public safety officers would require 12–14 years of benefits beyond that of their private sector counterparts. Public safety officers are also more likely to end careers or retire prematurely as a result of disabilities. They are more likely to suffer from a wide range of physical and/or psychological problems. This means they would be paying into Social Security for a shorter period and receiving benefits for a much longer period.

In addition to the fairness question and the economics of the issue, a legal question looms. The legislative history of the Social Security Act indicates that public employees were excluded because Congress was concerned about the Constitutionality of imposing a federal tax on or to dictate the affairs of state governments. This could seemingly present numerous hurdles, and if the inevitable Constitutional challenge determines that states would not be required to match the Social Security tax as does private sector employers, the economic feasibility argument eluded to above would render itself a foregone conclusion.

The council's report states that: "In light of several Supreme Court decisions dealing with Federal/State relationships in the area of labor law, it is now generally thought that there is no Constitutional barrier to compulsory coverage." However, it is not "generally thought" that the Constitutional issue in this matter has been decided. It is ambiguous and open for debate.

We urge you to carefully contemplate the full ramifications of forcing state-employed public safety officers into Social Security. Raiding the paychecks of devoted public servants is morally wrong. Looting the budgets of already strapped states and counties to bail out an inefficient, wasteful federal government would be reprehensible. Destroying a retirement system that should be emulated and replicated would be indefensible. The Constitutional argument remains unanswered. Inequitable benefits' packages would destroy morale. Perhaps most disturbing, after creating undue hardships for thousands of families for many years, Social Security could find its coffers just as empty several generations into the future.

Thank you for this opportunity to express our opinion. We hope you will seriously consider our concerns.

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**Statement of Jennifer DuCray-Morrill, Deputy Chief Executive Officer—Government Affairs & Program Development, State Teachers' Retirement System, State of California**

My name is Jennifer DuCray-Morrill. I am Deputy Chief Executive Officer—Government Affairs & Program Development of the California State Teachers' Retirement System (CalSTRS). CalSTRS has 518,000 active and retired teacher members and currently pays retirement, disability, and survivors' benefits to some 154,000 recipients. CalSTRS pays out \$238 million each month in retirement, disability, and survivors' benefits, totaling \$2.9 billion annually.

We very much appreciate the opportunity to present our views to the Subcommittee on the issue of imposing mandatory Social Security coverage on newly-hired State and local government workers.

Before describing the specific impact that mandatory coverage would have on CalSTRS, its active members, and its retirees, I would like to respond to a number of points raised at the hearing, particularly by the General Accounting Office (GAO) in its testimony.

There can be no serious question that the true driving force behind proposals to impose mandatory coverage of new State and local government workers is a new source of revenue for the Federal government. The Federal government would be requiring State and local governments to bear a significant additional cost burden in order to help bolster the solvency of the Social Security trust fund.

However, as the GAO recognizes in its testimony, while new Federal revenue may be the driving force behind mandatory State and local coverage proposals, revenue is not itself an appropriate justification for imposing mandatory coverage. As the GAO notes: "While Social Security's solvency problems have triggered an analysis of the impact of mandatory coverage on [Social Security] program revenues and expenditures, the inclusion of such coverage in a comprehensive reform package would

need to be grounded in other considerations.” (U.S. General Accounting Office, “Mandating Coverage for State and Local Employees,” Testimony before the Subcommittee on Social Security, House Committee on Ways and Means (GAO/T-HEHS-98-127) (May 21, 1998), at p. 4).

In searching for an appropriate policy justification, GAO points to the 1994-96 Social Security Advisory Council statement that mandatory coverage is “basically ‘an issue of fairness.’” (Id., at pp. 4-5). GAO then quotes the Advisory Council report to the effect that “an effective Social Security program helps to reduce public costs for relief and assistance, which, in turn, means lower general taxes. There is an element of unfairness in a situation where practically all contribute to Social Security, while a few benefit both directly and indirectly but are excused from contributing to the program.” (Id., at p. 5).

It is important to examine in detail just how this “fairness” consideration balances out.

As a threshold matter, the Advisory Council’s asserted rationale of equitably sharing the burden of Social Security as a social welfare program does not ring true as applied to State and local governments already struggling with the cost burdens of Medicaid, welfare, and other social safety net responsibilities which the Federal government has passed down to the States. Mandatory coverage threatens a significant payroll cost increase for State and local governments. It seems quite difficult to justify this additional cost burden on the ground that State and local governments—and State and local taxpayers—are not now bearing their fair share of social safety net responsibilities. Moreover, State and local governments have only two responses available to such an additional cost burden coming from the Federal government—raising taxes or cutting spending on other essential government services.

More fundamentally, by imposing mandatory coverage the Federal government would be seeking to carry out its commitment to the participants in the Social Security system by forcing State and local governments to cast aside the commitment they have made to their workforce and the participants in their retirement systems. State and local governments would be asked to largely dismantle for the future their successful retirement systems that have served millions of participants for decades, in order to solve a Federal problem that these State and local governments had no hand in creating.

States like California—which has pre-funded the CalSTRS teacher retirement program to pay out almost \$3 billion in benefits each year—would be asked to cast aside these decades of successfully providing retirement benefits to generations of workers, in order to force the future membership into a pay-as-you-go Social Security system that will provide these State and local government employees with reduced benefits at higher cost to State and local governments. It is not without clear irony that, at the same time mandatory coverage proposals are being discussed that would force States to largely dismantle successful pre-funded retirement systems in order to help pay for the inadequacies of the pay-as-you-go Social Security system, State and local government retirement systems are being examined by GAO and others as a model for how a pre-funded retirement plan can be achieved and managed in the government context.

If mandatory coverage is imposed, State and local governments would lose flexibility to tailor retirement benefits to the unique work histories of the broad range of occupations necessary for the diverse State and local services, giving way to the “one-size-fits-all” approach of Social Security. State and local governments would lose the flexibility to manage retirement costs directly, with such costs now largely being thrust upon them from the Federal government.

On the employee side, while the GAO testimony notes that mandatory coverage will “increase participation in an important national program,” the testimony produces no conclusive evidence that overall retirement benefits of new State and local government workers will be sustained, let alone improved, under any reasonable cost scenario for State and local governments. Indeed, as described below, actuarial studies undertaken for our system show that the current CalSTRS plan produces a much greater benefit than a plan coordinated with Social Security for the same level of contribution. Certainly the 364,000 active members of CalSTRS have not been clamoring to shift into Social Security.

This should not be surprising since the new State and local government workers mandated into Social Security would be expected to receive less in Social Security benefits than they contribute. The solvency problem facing the Social Security trust fund is a later-term problem when the Baby Boomers begin to retire en masse. The retirements shortly afterward by the new State and local workers mandated into Social Security will only exacerbate the problem unless these State and local workers forced into Social Security in fact will receive less in benefits than they contributed. Somehow, the “fairness” rationale failed to surface vis-à-vis State and local govern-



ment workers in the past when the situation was reversed and participants drew out more in benefits than they had contributed.

Social Security has been in place for some 63 years as a “pay-as-you-go” system. Employers and employees in one generation have paid employment taxes which are used to pay current benefits and, in turn, a later generation of employers and employees have paid employment taxes which are used to pay that preceding generation’s employees’ benefits. Consequently, there is a certain rough justice as to current employers and employees participating in the Social Security system.

It is inequitable to mandate nonparticipating State and local governments into Social Security at this late point. This legislation is asking the entering generation of State and local employees, and the State and local governments which employ them, to contribute at a high rate of tax to pay benefits for a prior generation of workers, none of whom worked for the State and local governments which are being mandated into Social Security. Compared to all of the current employers in the Social Security system, the upshot of mandating the non-participating State and local governments into Social Security is to provide all current benefits to someone else while imposing the current burdens on the mandated State and local governments and their employees.

It might have been “fair” to mandate State and local governments at the start—everyone would be treated equally, but it is unfair to wait until late in the game and then mandate coverage.

State and local governments have designed their retirement plans in reliance upon their exclusion from mandatory Social Security coverage. Benefits have been structured and trusts funded on this basis. State and local tax rates have been established which provide adequate sums to fund these retirement benefits along with the other expenses of State and local governments.

There is, understandably, a great deal of reluctance on the part of voters to increase State and local taxes. All parties, including those favoring mandating Social Security coverage for State and local government employees, concede that if coverage is mandated, benefit costs will increase substantially if State and local governments maintain the current level of benefits, even taking Social Security benefits into account. The alternative, and more likely scenario, is that benefits will be cut in order to maintain the current levels of taxation. That is unfair to State and local government employees.

This burden will be particularly hard on teachers who are disproportionately the group affected by mandatory Social Security coverage. At a time when schools, particularly schools in California, are straining to improve educational performance in the face of stringent budgetary restrictions, to add the cost of mandatory Social Security coverage would be a devastating blow.

In summary, Mr. Chairman, once “fairness” is considered in all of its aspects—and not just those that favor the Federal side—it becomes quite clear that “fairness” provides no true rationale for mandating new State and local government workers into Social Security.

Let me briefly outline the specific impacts that mandatory coverage would have on CalSTRS and its 518,000 active and retired participants.

#### CALSTRS AND OTHER EXISTING STATE AND LOCAL RETIREMENT SYSTEMS IN STATES THAT DO NOT PARTICIPATE IN SOCIAL SECURITY ARE SUCCESSFUL AND SHOULD NOT BE DISRUPTED

- State and local governments do an excellent job managing retirement plans and providing good benefits for their employees.

- The California State Teachers’ Retirement System (CalSTRS) pays out \$238 million each month in retirement, disability, and survivors’ benefits, for total benefits of \$2.9 billion annually. An average CalSTRS retiree’s annual benefit at retirement is approximately \$18,000.

- State and local government plans are more soundly funded than Social Security. State and local plans are sound because the necessary employer and employee contributions have been actuarially determined and put into trust funds and invested in accordance with sound portfolio management principles. State and local plans invest in a range of securities providing a greater return than the government bonds held by the Social Security “trust fund.”

- CalSTRS has a strong funding level, with assets representing 97% of accrued liabilities.

- CalSTRS retirees on average receive retirement benefits for 26 years. Two years of that payout represent the employee contributions, two years represent the employer contributions, and 22 years of that payout are funded by investment earnings.

—CalSTRS's assets totaled more than 22 times benefits paid in 1995–96. By contrast, Social Security's assets were less than 2 times annual benefits paid, providing much less opportunity for investment growth.

- By operating their own retirement systems, State and local governments are able to tailor benefits to the work histories of the uniquely broad range of occupations of State and local workers.

—Police and fire personnel retire earlier because of the physical demands of the job. Judges enter late in their careers and serve for a limited period. Teachers often have long, steady careers. The “one-size-fits-all” approach of Social Security determined in Washington provides no such flexibility.

—State and local government employers are able to manage retirement benefits and costs directly—rather than having costs thrust upon them by the Federal government—and employee groups have input on benefits through the bargaining and State legislative processes.

- CalSTRS strongly believes that all of its teacher participants should receive comparable benefits for the same service and pay. Mandatory Social Security coverage would disrupt that equity because new hires likely would receive less in benefits under a plan coordinated with Social Security than current CalSTRS members receive under the existing plan.

#### MANDATORY SOCIAL SECURITY COVERAGE FOR ALL STATE AND LOCAL NEW HIRES WILL HAVE A HARSH IMPACT ON NEW EMPLOYEES, CURRENT PARTICIPANTS, STATE AND LOCAL EMPLOYERS, AND THE STATES AND LOCAL RETIREMENT PLANS THEMSELVES

- Harsh cost impact or benefit cuts in the case of new hires

—If added to current pension costs, the 12.4% Social Security payroll tax cost for new teachers would create a major financial burden for California public schools. The average additional annual cost for a new hire would be at least \$1,600 each for the employer and the employee.

—The additional Social Security payroll tax burden approaches the normal cost of the current CalSTRS retirement plan (15.79%), leaving little room for the design of a retirement benefit to supplement Social Security for the new hires except in the unlikely event that new State and local funding can be found.

—State and local retirement plans produce substantially higher investment returns than Social Security. If Social Security is substituted for a large portion of the State and local retirement plan benefit, contributions to the State and local plan will have to increase to fund the same level of benefits. In California actuarial studies indicate that it would cost an additional 3% to 6% of payroll to fund a supplemental retirement tier that when combined with Social Security equates to the retirement benefits currently provided by CalSTRS.

—Actuarial studies show that the current CalSTRS plan produces a much greater benefit than a plan coordinated with Social Security for the same level of contribution, for essentially all combinations of age and service.

—Mandatory Social Security coverage would substitute an unfunded benefit under the pay-as-you-go Social Security system for the funded retirement benefit that the new State or local worker would have received under the State or local government retirement system.

—Given the fiscal and political difficulties of increasing State and local government retirement costs, it seems likely that State and local employers would respond to mandatory coverage for new hires by cutting benefits under the State and local retirement plan rather than increasing contribution costs.

- Adverse impact on current participants and existing State and local government plans

—As the GAO testimony notes, “Mandatory coverage and the resulting changes to benefit levels for newly hired employees are likely to result in reduced contributions to the current pension plan. The impact of reduced contributions on plan finances would depend on the actuarial method and assumptions used by each plan, the adequacy of current plan funding, and other factors.” (p. 10). Even though CalSTRS is currently well-funded, in the future the liabilities for the closed group of current participants could exceed assets, creating an unfunded liability. A substantial reduction in the contributions from new hires would have an adverse impact on the pay-down of any unfunded liability of the plan.

DUBIOUS BENEFIT FOR THE SOCIAL SECURITY TRUST FUND UNLESS STATE AND LOCAL WORKERS WILL RECEIVE LESS IN SOCIAL SECURITY BENEFITS THAN THEY CONTRIBUTE

- Mandating Social Security coverage for State and local new hires would provide a short-term cash flow into the Social Security trust fund. But the Social Security trust fund has no short-term funding or liquidity problem.
- The solvency problem facing the Social Security fund is a later-term problem when the Baby Boomers begin to retire en masse. The retirements shortly afterward by the new State and local workers mandated into Social Security will only exacerbate the problem unless these State and local workers forced into Social Security in fact will receive less in benefits than they contributed.
- The payroll tax contributions of the State and local workers mandated into Social Security will merely be invested in Federal debt, not growing investments, and hence there will be even greater dependence on the future taxing resolve of the Federal government when that debt must be cashed in to pay benefits.

CONCLUSION

Mr. Chairman, we would strongly urge you and the other Members of the Committee, in examining proposals for mandatory coverage of State and local government workers, to look beyond the siren call of short-term revenue and to consider the severe cost and dislocation that would be imposed on State and local governments and their retirement systems that have successfully funded retirement benefits for generations of workers in public service.

Thank you for the opportunity to present our views.

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**Statement of Charles G. Hardin, President, Council for Government Reform**

Mr. Chairman, thank you for allowing me to testify for the record regarding the addition of state and local government workers to the Social Security system. I greatly appreciate this opportunity to share the views of our 350,000 members with the Subcommittee.

As we are all aware, Social Security is facing its greatest crisis. Soon, demographic trends will push our nation's retirement income security system into virtual bankruptcy.

One of the proposed solutions to this problem is to corral all newly hired state and local government workers into the current Social Security structure.

I firmly believe that this is the wrong approach. We should be looking to build a structure that can withstand the demographic storm brewing on the horizon, not adding more ballast to a sinking ship.

In the short run, adding newly hired state and local government workers will make Social Security's balance sheet look better. But this is only a short-term fix. Soon-to-be-hired state and local employees have no one to speak for them and Congress must take care not to use them for its own purposes.

What will happen when we add these workers to our already overburdened retirement income structure? With Social Security's current rate of return, our problems will only get that much bigger in the long run.

Right now, state and local government workers who are excluded from Social Security are enjoying high returns on their retirement investment. The mammoth California Public Employees Retirement System (CALPERS) reported a 20.1% rate of return during the 12 months ending on June 30, 1997. And the Virginia Retirement System returned 20.6% for their pensioners during the calendar year of 1997.

While CGR would much prefer to see individually directed retirement investments, these rates of return are very solid compared with Social Security's near-negative return rate. Privately-run mutual funds hold the same advantages of state or local run funds, but they could not be held hostage to political considerations as has happened in the past.

State and local government workers are not workers who are in need of rescue by Social Security. In fact, the millions of workers in Social Security can only wish they received such good return on their investments.

We should be moving in the opposite direction. We should be looking at how these state pension systems protect the retirement income security of their members and we should be designing a plan to apply these principals to the millions of workers who face Social Security shortfalls in their future.

In addition, by carving out new hires in state and local governments, we will essentially be creating a new "notch." Newly-hired state and local government employees will look with anger and envy at their predecessors' fat retirement savings and wonder why Congress consigned them to the miniscule Social Security benefit.

And the simple answer will be: Congress wanted to spend their money.

Fixing Social Security should start with a fundamental rethinking of how the program is structured. The old nostrums of tax hikes, benefit cuts, and corraling more workers into the system have been played out. They don't work and only make things worse for future generations.

I urge the subcommittee to reject any proposal to include newly hired state and local government workers in the current Social Security plan and to push instead for wider reform that will secure the retirement income of current retirees, current workers and future workers.

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ELEANOR DEUTSCH  
BROOKLYN, N.Y. 11218-1442  
May 28, 1998

A.L. Singleton  
Chief of Staff  
Committee on Ways and Means  
U.S. House of Representatives  
1102 Longworth House Office Building  
Washington, D.C. 20515

Dear Chairperson:

I would like to take this opportunity to thank the Subcommittee on Social Security for giving consideration to individuals like myself to take part in these legislative proceedings.

Those immediately affected by the Government Pension Offset fully understand the impact of these proceedings and are very grateful that they have finally come to fruition.

I have suffered for several years financially and because of this offset I am being forced to exhaust my lifetime savings. My husband and I worked all of our lives and contributed to Social Security and my government pension fund for which may I add is a very small amount. Anything you can do to change or revise the law will be a personal gratification not only to me but to thousands of government workers.

The Government Pension Offset is a very unfair law and I am sure after great deliberation it can be revised to make it right to all concern.

I have two main points to make:

1) The 1977 Amendments to the Social Security Act was written to bring equity to the program and yet the legislation was amended in January 1983 by Public Law 97-455 and again in April, 1983 by Public Law 98-617, again in November, 1984 by Public Law 98-21 and finally in December, 1987 by Public Law 100-203.

I count four amendments to the original law in 1977 which indicates to me that these changes were necessary to correct legislation that was either poorly written or unpopular with those individuals later exempted and

2) As an applicant in 1995, I feel that there was no choice given to me where I could meet one of the exemptions. My years of dedicated service were behind me, I did not belong to an exempted group, there was no offer for me to change my pension plan for FERS and my single voice could not be heard in Congress.

For the past several years I could not understand why my benefits were decreased by a two-thirds formula. As my resources are steadily being exhausted I become more and more dependant on my benefits which places me in a unfair position of being more reliant on the government instead of being self-reliant for myself.

Can you imagine the thousands and maybe millions of constituents depending more on government benefit programs?

The time is now appropriate for Congress to right a wrong for those beneficiaries who have struggled to meet their every day living expenses.

In closing, it is my only wish that we are given and are compensated in the future so that life will be much easier in our golden years.

I thank you and your staff for finally giving this the proper attention it deserves.

Sincerely yours,

ELEANOR DEUTSCH

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**Statement of Patrick L. Doyle, Director, Division of Social Security,  
Commonwealth of Kentucky**

These are the comments of the Kentucky Division of Social Security on the Subcommittee Social Security's hearing on mandatory social security coverage for newly hired employees of state and local governments. Brief comments concerning GPO and WEP are also included.

The exception from social security coverage for state and local government employees was included in the original version of the Social Security Act passed in 1935. This exception is the federal government's recognition of its constitutional limitation to mandate a social security employer tax on the states and their political subdivisions.

The 1950 amendments to the act, effective January 1, 1951, allow a state to enter into a voluntary agreement with the federal government permitting the state and its political subdivisions to provide social security coverage for their employees. This voluntary coverage concept was included in Section 218 of the Social Security Act. The Omnibus Budget Reconciliation Act of 1990—which requires social security coverage for all state and local employees not covered under a Section 218 agreement, or state and local employees not belonging to a qualified, public retirement system—avoided the constitutionality question by retaining the states' and their political subdivisions' right to determine if employees will be covered under social security or a qualified, public retirement system. The new-hire proposal for universal social security does not provide for any options to state and local governments.

The Tenth Amendment to the Constitution expressly provides that "the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or the people." After decades of erosion, the Tenth Amendment's revival was initiated by the United States Supreme Court in 1991 in *Gregory v. Ashcroft* and further strengthened in the landmark *New York v. United States* decision in 1992. The High Court's 1992 ruling included the following statement: "Congress may not simply 'commandeer' the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program."

Aside from the obvious question of constitutionality, the imposition of universal social security coverage would cause havoc on the organization of many state retirement systems. Some Kentucky retirement systems were created prior to 1951 specifically for certain career employees, such as teachers, police and firefighters, when social security coverage was not available to public employees. These non-social security retirement systems were designed to provide these employees with a complete benefit structure of retirement, disability and health insurance coverage that was based on the unavailability of social security coverage.

The imposition of the "new hire" rule places Kentucky's retirement systems in the position of having to review all the pension plans for the affected employees. Sound pension policy dictates that Kentucky must consider the issue of equity to its employees, as well as the reasonableness of the income replacement at retirement. If new-hires retain the benefits of current pension plans, then they would be entitled to a significantly higher level of income replacement at the time of retirement (current pension benefits plus social security), at a significantly higher cost to the taxpayers. Kentucky cannot justify paying higher benefits simply because of the hire date of an employee. Kentucky would be forced to either increase the benefits of current "old hires" in the interest of equity or to establish new retirement systems or new tiers for the new hires with equivalent total income replacement values. This process of creating an entirely new retirement system for a new class of employees requires legislative and policy considerations that cannot be accomplished with a stroke of a pen.

The economics of establishing a separate system for the new hires could undermine the actuarial soundness of the old system due to the loss of new members contributing to the system. A two-tiered system, while actuarially more sound, would likely lead to further legislative pressures to increase benefits or to expensive lawsuits brought by either of the employee groups.

If, and when, the above problems are legally overcome, the implementation of the new-hire concept of social security must be implemented at significant cost and effort to state and local employers. Kentucky's state government and its 216 city governments, county governments, boards of education and smaller political subdivisions effected by the change would incur first year employer contribution costs of an estimated \$5 million. This, of course, must be matched equally by employee con-

tributions. (The cost to retirement systems in Kentucky to implement the "new hire" proposal could possibly exceed the amount of "new-hire" social security contributions collected from Kentucky in the first year.)

Over and above the financial drain of the social security contributions on already very limited resources, all government employers would be required to modify their payroll systems to accommodate another class of employee. This would be very expensive for those governmental employers who have computerized payrolls system. One must also factor in the cost of training payroll personnel about the modified payroll system, maintaining the records of a new employee group and the additional withholding and reporting requirements the "new-hire" proposal would mandate.

It has been said that the "new-hire" proposal would ease the administrative burden of the social security program for the Internal Revenue Service and the Social Security Administration. One only has to examine current medicare coverage with its new-hire provisions to realize that it is very complicated and requires additional and constant administration by both the state and local employers and the federal agencies.

In the event this proposal becomes law, Section 218 must remain in place to ensure the details of social security coverage for the employees continue under all existing Section 218 Agreements. Each of Kentucky's 1,500 agreements is unique to the applicable governmental employer. State and local governmental employers also need the avenues Section 218 provides to allow for social security coverage of veteran ("old-hire") employees, if they so desire, as in current medicare-only coverage.

Congress recognized a basic inequity in the application of social security benefits to certain groups of public employees without social security coverage when the Government Pension Offset and the Windfall Elimination Provision were enacted. The GPO and WEP benefit reductions addressed these inequalities. Congress may wish to consider simply fine tuning the GPO and WEP provisions as this would be far more appropriate and efficient than enacting mandatory social security legislation that would create a new class of public employees.

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## Statement of Edith U. Fierst, Member, 1994-96 Advisory Council on Social Security

### INTRODUCTION

I very much appreciate this opportunity to present my views in writing since unhappily I was not able to accept the invitation of your Staff Director, Kim Hildred, to testify in person. The views expressed are mine alone; I do not appear on behalf of any clients, persons or organizations.

### REASONS FOR BRINGING NEW HIRES UNDER SOCIAL SECURITY

The members of the 1994-96 Social Security Advisory Council, whatever their views on the contentious issue of privatization, were unanimous in recommending that all new hires by State and local governments be brought under mandatory coverage of Social Security. Doing so would cut the long-run estimated deficit in the trust fund by 0.25 percent of payroll because contributions would start to flow into the trust fund promptly after mandatory coverage were enacted, but the benefits payable to State and local employees would not become due for some years. The trust fund would profit from the time lapse between collecting the tax and paying benefits.

In making this recommendation the members of the Advisory Council were mindful of several major advantages that would flow to covered employees from being brought under coverage of the national retirement system. These include:

1. *Portability.* Bringing newly hired State and local employees under coverage of Social Security would enable them to move from one job to another without sacrificing retirement benefits. This missing portability is often very important to employees, although little publicized. Traditionally employers have thought of the lack of portability of pension plans as a way of locking in their labor force, and the attention of employee leaders has been focused primarily on those who stay, not on those who leave.

I experienced the pressures created by lack of portability when I worked for the Federal Government under the Civil Service Retirement System (CSRS). The time came when I wanted to leave for other employment, but realized doing so would cause me to incur a major financial loss. CSRS offers retirement without reduction for early retirement at a younger age than does Social Security—at age 55 after 30

years of service, at age 62 after 5 years of service—and CSRS indexes benefits to the cost of living only for those who have retired under the system. Those who leave before retiring must wait to age 62 before starting to receive the benefits they have earned; they also sacrifice the COLAs that would be payable to retirees in the years between leaving government service and reaching age 62. Moreover, they lack the protection of survivor annuities for their widow(er)s if they die in those interim years.

As a consequence of these and perhaps other disincentives, many workers covered by CSRS feel locked in. They become time-servers, watching the calendar until their earliest possible date for retirement. This is not good for either the workers or their employers. Many press for abolition of their jobs so they can retire at age 50 after 20 years of service, and for a number of reasons, their supervisors are often glad to help them out. This has entailed considerable cost to the taxpayers.

Fortunately this problem was solved for future Federal employees in 1984 when a new retirement law became effective, bringing new Federal hires under Social Security, but analogous problems continue to plague employees of the State and local governments and the governmental units that employ them. All would be happier if retirement benefits were made portable by bringing new hires under Social Security.

2. *Cost of living increases.* Not only does Social Security compute initial benefits under a formula that takes into consideration average wage increases before the employee reaches retirement age or qualifies for disability or dependent benefits, it also guarantees that the purchasing power of benefits will be retained through annual cost of living increases indexed to price increases. The plans of state and local government for public employees rarely, if ever, provide full COLAs. Today, we are in a period of relative price stability, when cost of living increases may seem to matter little, but this stable economy may not last. Without it, the security of retirees is at risk, as we have seen so often in parts of the world with runaway inflation.

3. *Security for dependents.* Social Security provides monthly benefits for spouses, surviving widows and widowers and children at no additional cost to those whose dependents are covered. Individual employees do not need to make an election to be covered, nor do they pay extra for it. Rather, these benefits are the insurance part of Social Security. They have substantial value.

By contrast, under many State and local government plans, coverage is optional with the employee, and those who elect coverage pay for it through reductions in their own retirement benefits.

I saw how this works when a client came to me while I was in the private practice of law. The client was highly educated and intelligent, a star at a local think tank. His father, who had been a well-respected state government worker, was recently deceased. Much to the family's surprise and consternation, the father had opted against a survivor annuity for his wife because paying for it would have reduced his retirement benefits. Suddenly my client's mother was left without income after a marriage of 50 years; fortunately in her case the children were able and willing to take on the burden of supporting their mother. But we all know that is not true for everyone.

Social Security has made lack of protection for surviving spouses a non-problem for covered families. For them, the desperation that used to beset elderly widows and their families is a thing of the past. While many have reason to worry because the benefit is too low (something we can and should remedy by increasing benefits for survivors of two-earner couples), no one, not even a divorced spouse after a marriage that lasted at least ten years, is excluded.

Some of those who favor privatization have been spreading a myth that while some public plans based on individual accounts make these accounts available to young widows, the only benefit available to those covered by Social Security is \$255 in funeral expenses. The truth is that Social Security provides a monthly benefit for eligible mothers until the youngest child reaches age 16 and an additional benefit for surviving children until they reach age 18, or if later, finish high school or reach age 19. If the child is disabled before age 22, the child's benefits last as long as the child is disabled and the eligible caretaker's lasts as long as the child needs care. The value of this insurance for the family of an average wage worker with two children and a mother of 27 is estimated at \$307,000.

Public employees and their families, like everyone else, need this coverage. They can get it only if they are covered by Social Security.

4. *The Public Pension and Windfall Offsets.* Both the public pension and windfall offsets were designed to protect the Federal Government from the obligation to make excessive payments to retirees covered under both Social Security and pensions not covered by Social Security. They work as follows:

A. *The Public Pension Offset* (PPO) reduces benefits payable to spouses or survivors by Social Security by two-thirds of the benefits earned by that spouse or survivor in a public job not covered by Social Security. Thus a Social Security spouse or survivor benefit of \$300 is reduced to zero if the spouse has earned a pension of \$450 a month or more in non-covered public employment.

Many retirees do not learn of the public pension offset until they are about to retire. Then they are shocked and believe they have been cheated by an unfair policy. I'm sure you and other Members of Congress hear from them. However, the protesters do not understand that the PPO is analogous to the dual entitlement rule under which Social Security benefits payable to spouses and survivors are reduced by the benefits they themselves earned as workers. Indeed, the dual entitlement rule demands a total offset, not one that reduces overlapping benefits by only two-thirds. The PPO is a smaller offset presumably because public pensions substitute for both Social Security and private pensions payable to those in private employment.

While the public pension offset might be improved at the margins, in view of the dual entitlement rule which reduces benefits for those covered under Social Security both as workers and spouses (or survivors), it is hard to make the case for eliminating it altogether except by bringing public employees under coverage of Social Security.

B. *The Windfall Offset* reduces the replacement rate of Social Security payable to retirees with only short-term coverage under Social Security if they also had non-covered employment. Its purpose is to restrict the number of employees entitled to payment of the highest replacement rate under Social Security's progressive formula. Under that formula, a 90 percent replacement rate is paid for the initial roughly \$5500 a year in earnings (indexed); this high return is designed to assure minimum adequacy for persons who worked many years at low wages. The high replacement rate was never intended to give a windfall to short-term employees with high pay whose lifetime covered earnings are low because most of their work was done under non-covered plans.

Before the windfall offset was enacted, persons who had worked for many years in exempt public employment sometimes received benefits from Social Security as high as those whose low-paid lifetime careers were under Social Security. This was unfair and unintended. Its cost to Social Security was substantial.

Nevertheless those who are adversely affected by the windfall offset are often surprised at retirement age to learn about it; they, like those covered by the PPO, may feel cheated and outraged.

Perhaps the windfall offset could be moderated at the margins, but I have heard no good arguments for eliminating it for employees whose major career was in non-covered public employment. The best solution is to bring these employees under coverage of Social Security during their years of public employment.

#### ATTITUDE OF PUBLIC EMPLOYEES

Many public employees say they prefer plans offered by their State or local government employers to Social Security. Frequently they lack understanding of the very real advantages of coverage under Social Security outlined above.

In addition, typically these employees do not understand that their large benefit amounts derive from generous contributions by their employers rather than from their exempt status. They may not realize that private pensions provide similar benefits to those also covered by Social Security or that they could have the equivalent. Public employers could fund separate plans with the amount they now contribute in excess of the 6.2 percent of earned income employers are required to contribute to Social Security or the 12.4 percent employees and employees are required to contribute. If they did so, many public employers would provide excellent pension plans, making their employees much better off than they are now because they would have both Social Security and pensions.

The recent extraordinary performance of the stock market has given ammunition to those who prefer separate coverage dependent upon private investment. Investment advisers and managers who earn their living by working for the funds of these plans are particularly articulate in their defense. Their self-interest in these plans should be taken as a caution against too much reliance on their views.

I understand that it is difficult for Members of Congress who represent large numbers of uncovered public employees to vote to include them when their leaders oppose bringing them under Social Security. Nevertheless I believe public employees can be persuaded to accept Social Security coverage by a combination of the advantages to public employees of Social Security coverage listed above and the realization that Social Security is not an either/or to special plans for public employees.



## INTEREST OF PUBLIC EMPLOYERS

Many state and local governments have been overpromising future retirement benefits to placate employees who demanded pay increases that could not be afforded immediately. These governmental units could seize the opportunity of to restructure their retirement packages at the time of changeover to Social Security, thus solving a big financial crisis which awaits them in the future. And they could do this while at the same time providing their employees supplemental plans, possibly of an individual accounts type that would make everyone happy. Inasmuch as the coverage of State and local government employees would apply to new hires only, there would be time for the governmental units to phase in such coverage and absorb any transitional expenses while at the same time, initiating supplemental plans for covered public employees.

## CONCLUSION:

I regret I could not be here to answer your questions, but I would be pleased to do so if anyone wishes to contact me.

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**Statement of Alfred K. Whitehead, General President, International Association of Fire Fighters**

Mr. Chairman. My name is Alfred K. Whitehead, and I am the General President of the International Association of Fire Fighters. I greatly appreciate this opportunity to express the views of the nation's more than 225,000 professional fire fighters and emergency medical personnel on the vitally important issue of mandatory Social Security coverage of public sector employees.

The IAFF strongly supports efforts to ensure the future solvency of the Social Security system. Thousands of our members are counting on Social Security as an important part of their retirement security, and we are committed to preserving the system for them and their families. We are also committed to protecting the retirement security of those fire fighters who are currently outside the Social Security system.

On behalf of both of these groups, the IAFF is adamantly opposed to the mandatory coverage of those public employees who are not currently part of the Social Security system. Mandatory coverage would wreak havoc with the economic security of fire fighters who are currently not covered by Social Security, and would only produce a short term cosmetic benefit to the Social Security system. In the long run, both groups of fire fighters would be harmed by mandatory coverage.

## BACKGROUND

When the Social Security system was created in 1935, government employees were expressly excluded. It wasn't until the 1950s that state and local government agencies were given the option to join the system. Even then, fire departments in 24 states were prohibited from voluntarily joining the Social Security. It wasn't until 1994 that all fire fighters had the right to vote on whether or not to enroll in Social Security.

In response to this long-standing arrangement, state and local governments that were outside the scope of Social Security developed their own retirement systems that took into account the unique needs of their employees. These plans have been extremely successful in meeting the retirement security needs of their members. On the whole, these plans offer higher benefits at lower cost than Social Security.

The ability to tailor retirement plans has been especially important to the nation's fire fighters and emergency medical personnel. Fire fighters retire at much earlier ages than the general population—well before eligibility for Social Security benefits. In many cases, fire fighters are legally required to retire at a given age, and therefore do not even have the option of working until age 62. In addition, fire fighters are far more likely than the general population to leave work due to a disability.

This ability to tailor the retirement benefits is the primary reason that so many public safety agencies have opted to remain outside the Social Security system. While only 30% of all public employees are not covered by Social Security, fully 76% of fire fighters and police officers are not covered. It is important to note that the creation of specially tailored retirement plans did not come cheaply. In many cases fire fighters gave up increased wages and other benefits in exchange for better pensions, including disability benefits and survivor benefits.

## PROBLEMS WITH MANDATORY COVERAGE

There are four distinct problems that the members of my organization have with proposals to extend Social Security coverage to all public sector employees. First and foremost, it would wreak havoc with the specially tailored fire fighter pension plans. Even if mandatory coverage is required only for new hires, the pension systems that fire fighters helped design, and in many cases gave up wage increases to get, could not be sustained. The system would collapse, leaving the retirement security for thousands of fire fighters in shambles.

Second, mandatory Social Security coverage would amount to a 6.2% income tax on public sector employees. The vast majority of these workers are middle-income Americans who are struggling to make ends meet. This is precisely the wrong group that our nation should be looking to to shoulder more of the current tax burden. Consider a fire fighter who is supporting a family of four on \$32,500 a year. Mandatory Social Security coverage would cost that family over \$2,000 in increased taxes. Imposing a significant new tax on middle-income wage earners is counterintuitive and would be counterproductive.

Third, mandatory Social Security coverage would impose an enormous financial burden on the public safety agencies that employ our members. This increased cost will necessarily result in either reduced services or increased local taxes, or both. Many fire department budgets are already stretched to their maximum, and it simply will not be possible to sustain further budget cuts without jeopardizing public safety.

Finally, mandatory coverage of public employees will harm the Social Security system. While mandatory coverage will bring a short term infusion of cash into the system, Congress needs to show the courage to resist the quick fix and look at the protecting the system in the long run. The millions of workers who are brought into the system under mandatory coverage will one day begin receiving benefits. Since the amount of contributions made by an individual does not equal the benefits paid by the system, bringing a sizable new group of employees into Social Security is a guaranteed money loser and a significant threat to the long-range solvency of the system.

## ARGUMENTS MADE IN FAVOR OF MANDATORY COVERAGE

Although the true reason for extending Social Security coverage to all public employees is undoubtedly the short term cash infusion into the system, advocates of the proposal argue that the change is justified for two reasons—both of which are highly suspect.

First, they argue that employees need Social Security. Because not all employers can be counted on to provide a pension, it is the responsibility of the federal government to ensure that all workers have some minimal level of retirement income. While valid on its face, this argument ignores a significant change in the law made in 1990. In that year, Congress voted to extend Social Security coverage to any public employee who is not covered by a pension plan that is at least comparable to Social Security.

Second, they argue that many public employees who are not covered by Social Security nevertheless qualify for benefits either because their spouse is covered or because they contribute to Social Security in a second job. To the extent that either of these situations is inequitable, Congress has already addressed the problem with the Spousal Offset and the Windfall Offset which reduce Social Security benefits paid to any individual who is receiving a pension from employment that is not covered by Social Security.

## CONCLUSION

Mr. Chairman, just last week a member of our organization testified before another subcommittee of this distinguished body. That hearing was called to explore ways that the United States government can adequately honor the nation's public safety officers for their extraordinary valor. Members of the Subcommittee appeared deeply moved as they listened to the tales of heroism displayed by fire fighters and law enforcement officers who selflessly risked their lives to save the lives of others.

A mere seven days later my organization is appearing before you to ask—to plead—that you not recklessly jeopardize the retirement income of these same heroes. If Congress truly wants to honor its nation's domestic defenders, let it begin by preserving their economic security.

Thank you.

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**Hon. Barbara A. Mikulski, a U.S. Senator from the State of Maryland**

Mr. Chairman, I want to thank you for having this hearing and for permitting me to provide testimony on a very important issue, the Government Pension Offset.

The Pension Offset is an issue that is very important to me, very important to my constituents in Maryland and very important to government workers and retirees across the nation.

First, I want to thank Representative Jefferson for his leadership in the House of Representatives on Government Pension Offset reform. He has introduced important legislation which I hope this committee and the House will soon approve.

I have introduced a similar bill in the Senate, S. 1365 The Government Pension Offset Reform Act, to modify this heartless rule of government that prevents current workers from enjoying the benefits of their hard work in their retirement. I want the middle class of this Nation to know that if you worked hard to become middle class you should stay middle class when you retire.

As many in this room know, under current law, there is something called the Government Pension Offset law. This is a harsh and unfair policy. Let me tell you why. If you are a retired government worker, and you qualify for a spousal Social Security benefit based on your spouse's employment record, you may not receive the full amount for which you qualify because the Pension Offset law reduces or entirely eliminates a Social Security spousal benefit when the surviving spouse is eligible for a pension from a local, state or federal government job that was not covered by Social Security. This policy only applies to government workers not private sector workers.

Let me give you a hypothetical example of two women I call Helen and her sister Phyllis. Helen is a retired Social Security benefits counselor who lives in Woodlawn, Maryland. Helen currently earns \$600 a month from her federal government pension. She's also entitled to a \$645 a month spousal benefit from Social Security based on her deceased husband's hard work as an auto mechanic. That's a combined monthly benefit of \$1,245.

Phyllis is a retired bank employee also in Woodlawn, Maryland. She currently earns a pension of \$600 a month from the bank. Like Helen, Phyllis is also entitled to a \$645 a month spousal benefit from Social Security based on her husband's employment. He was an auto-mechanic too. In fact, he worked at the same shop as Helen's husband.

So, Phyllis is entitled to a total of \$1,245 a month, the same as Helen. But, because of the Pension Offset law, Helen's spousal benefit is reduced by  $\frac{2}{3}$  of her government pension, or \$400. So instead of \$1,245 per month, she will only receive \$845 per month. This reduction in benefits only happens to Helen because she worked for the government. Phyllis will receive her full benefits because her pension is a private sector pension. I don't think that's right and that's why I have introduced my legislation.

The crucial thing about Government Pension Offset Reform Act that I have proposed is that it guarantees a minimum benefit of \$1,200. So, with this reform to the Pension Offset, Helen is guaranteed at least \$1,200 per month. Let me tell you how it would work.

Helen's spousal benefit will be reduced only by  $\frac{2}{3}$  of the amount her combined monthly benefit exceeds \$1,200. In her case, the amount of the offset would be  $\frac{2}{3}$  of \$45, or \$30. That's a big difference from \$400 and I think people like our federal workers, teachers and our firefighters deserve that big difference.

Why should earning a government pension penalize the surviving spouse? If a deceased spouse had a job covered by Social Security and paid into the Social Security system, that spouse expected his earned Social Security benefits would be there for the surviving spouse. Most working men believe this and many working women are counting on their spousal benefits. But because of this harsh and heartless policy, the spousal benefits will not be there, your spouse will not benefit from your hard work, and chances are, you won't find out about it until your loved one is gone and you really need the money.

The Government Pension Reform Act guarantees that the spouse will at least receive \$1,200 in combined benefits. It guarantees that Helen will receive the same amount as Phyllis. I have introduced this legislation, because these survivors deserve better than the reduced monthly benefits that the Pension Offset currently allows.

They deserve to be rewarded for their hard work, not penalized for it. Many workers affected by this Offset policy are women or clerical workers and bus drivers who

are currently working and looking forward to a deserved retirement. These are people who worked hard as federal employees, school teachers, or firefighters.

Frankly, I would repeal this policy all together. But, I realize that budget considerations make that unlikely. As a compromise, I hope we can agree that retirees who work hard should not have this offset applied until their combined monthly benefit exceeds \$1,200.

In the few cases where retirees might have their benefits reduced by this policy change, my legislation contains a "hold harmless" provision that will calculate their pension offset by the current method. My legislation would also index the minimum amount of \$1,200 to inflation so retirees will see their minimum benefits increase as the cost of living increases.

Mr. Chairman, I believe that people who work hard and play by the rules should not be penalized by arcane, legislative technicalities. If the federal government is going to force government workers and retirees in Maryland and across the country to give up a portion of their spousal benefits, the retirees should at least be allowed a livable level of benefits.

Thank you again, Mr. Chairman, for having this hearing on this important issue. I hope that as the debate on the future of Social Security continues, this issue, and other issues that penalize people for hard work will be addressed and will be remedied.

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### **Statement of Robert T. Scully, Executive Director, National Association of Police Organizations, Inc.**

#### **I. INTRODUCTION: BACKGROUND AND OVERVIEW**

I am Robert Scully, the Executive Director of the National Association of Police Organizations, otherwise known as NAPO. I am a retired police officer who served for 25 years with the Detroit Police Department. I also served as a full-time elected officer of the Detroit Police Officers Association and was a collective bargaining team member from 1973-92. In addition, I was NAPO's elected president from 1983 to 1993.

NAPO is a national non-profit organization representing State and local law enforcement officers. NAPO is a coalition of police associations and unions serving to advance the interests of law enforcement officers through legislative and legal advocacy and educational programs. NAPO represents more than 4,000 law enforcement unions and organizations, with over 220,000 sworn law enforcement officers, 3,000 retired officers, and more than 100,000 citizens dedicated to crime control and law enforcement.<sup>1</sup>

Mandating Social Security taxes on the vast majority of public safety officers, primarily law enforcement officers, firefighters, and rescue squad workers,<sup>2</sup> would have serious implications and unintended consequences. It would have a dramatic and negative impact on the recruitment and retention of well-qualified public safety officers and their current pension funds. Even mandating that only new hires be included in the system would still have serious unintended and possibly devastating consequences. Such a Federal mandate would strain State and local government budgets and would probably reduce current salaries, freeze future pay raises, and curtail or eliminate other benefits, such as retiree health insurance, retirement pensions, death benefits, and line-of-duty disability pay for public safety officers.

#### **II. BRIEF HISTORY OF THE APPLICABILITY OF SOCIAL SECURITY TO STATE AND LOCAL PUBLIC EMPLOYEES**

When established in 1935, the Social Security program covered all private sector workers in commerce and industry and excluded State and local government employees from Social Security coverage. The legislative history of the Social Security Act indicates that these employees were excluded because most had their own retirement systems and because Congress was concerned about the constitutionality

<sup>1</sup> Many of our statewide 'umbrella' groups are composed of hundreds of State and local member organizations, whose members are also NAPO members.

<sup>2</sup> For purposes of this statement, I am using the definition "law enforcement officer" contained in 42 U.S.C. § 3796b(5). That provision states: "Law enforcement officer" means an individual involved in crime and juvenile delinquency control or reduction, or enforcement of the laws, including, but not limited to, police, corrections, probation, parole, and judicial officers."

of imposing a Federal tax on State governments, an issue which has never been litigated.

In 1950, Congress added Section 218 of the Act which allowed for voluntary participation in the system by State and local employees not covered by public retirement systems. Then, in 1954 this provision was amended to permit voluntary participation by those State and local employees who were covered in a public retirement system, if a State or local government agency entered into an agreement with the Federal government.

In 1983, Congress once again amended the 1935 Act, making several relevant changes. First, State and local government agencies participating in the Social Security system (whose employees were voluntarily covered) could no longer exit from the system; for these employees, it was no longer voluntary. Second, all private sector and government employees hired after March 31, 1986, were covered by Medicare health insurance, with matching contributions from employer and employees. Third, by 1991, all State and local government employees not covered by a public retirement system were required to be in the Social Security system, which is in effect today.

The Social Security Administration estimates that 4.9 million State and local government employees are not covered by the system (although there may be more than that). Seven states, California, Ohio, Texas, Massachusetts, Illinois, Colorado, and Louisiana account for a large percentage of the non-covered public employee payroll.

The 1980 "Report of the Universal Social Security Coverage Study Group," which lead to the 1983 amendments, stated:

Unfortunately, in contrast to the case with the Federal workforce, the likely costs of requiring Social Security coverage for all State and local government workers are considerable. Because most existing State and local pension plans lack many of the features of Social Security, the new coordinated systems would cost many State and local governments more than they are paying to operate their noncoordinated plans. We should not forget that these increased costs usually translate into superior retirement, disability, and survivors protection for State and local government employees. Nonetheless, in these times of fiscal constraint at all levels of government, the Federal legislature should move cautiously in imposing new costs on State and local governments. In addition, many current State and local government plans are pay-as-you-go; hence, imposing the Social Security payroll tax . . . "crowds out" revenue that governments were anticipating for paying future benefits based on their existing pension plans.<sup>3</sup> [Emphasis added.]

### III. SPECIAL PENSION NEEDS OF STATE AND LOCAL PUBLIC SAFETY EMPLOYEES AND THE UNINTENDED CONSEQUENCES OF IMPOSING SOCIAL SECURITY TAXES ON THEM

Best estimates by the Public Pension Coordinating Council for 1996 (the most recently available data) indicate that 76 percent of State and local public safety personnel do not pay Social Security taxes and are not covered by the system.<sup>4</sup>

#### *A. Special needs of public safety officers and inadequacy of Social Security:*

Let me describe the dilemma faced by public safety officers when Social Security's very limited disability, death, and early retirement benefits are factored in, compared with current pension systems. Simply stated, the Social Security system was not designed for police officers and firefighters.

First, being an active police officer is a younger person's job. This is due to the special dangers and physical stresses of police work, often resulting in a disability or forcing police officers into an earlier retirement, as these stresses mount. During the last century and especially the last 50 years, State and local governments have developed pension systems which acknowledge that police and firefighter jobs are very different than normal careers, with a set of dangers and stresses not faced by most other professionals. These systems take into account that law enforcement officers and firefighters usually must undergo a career change in middle age, usually in their late 40s to mid 50s. In many police departments, a large percentage of po-

<sup>3</sup> Joint Committee Print, Committee on Ways and Means and Committee on Post Office and Civil Service, U.S. House of Representatives, 96th Cong. 2d Session, March 27, 1980, WMCP: 96-54, reprinting "Report of the Universal Social Security Coverage Study Group," transmitted by the U.S. Secretary of Health, Education, and Welfare on March 24, 1980, pp. xiii-xiv.

<sup>4</sup> This data is from the 1997 Survey of State and Local Government Employee Retirement Systems, Government Finance Officers Association, Chicago, Illinois. This survey is done for members of the Council, which is composed of the National Association of State Retirement Administrators, National Conference on Public Employee Retirement Systems, National Council on Teacher Retirement, as well as the Government Finance Officers Association.

lice officers will be sufficiently disabled at all ages for varying lengths of time and thus be unable to perform their duties as officers. Therefore, most governments have recognized that public safety officers need certain protections and benefits in recognition of the nature of their jobs. I will describe a typical system, the City of Detroit Policemen and Firemen Retirement System, shortly.

Social Security provides no comparable disability benefits for police officers and firefighters. Social Security requires that an employee be unable to perform any substantial and gainful employment. This means that an individual unable to perform regular and continuous duties as a public safety officer, who would now receive some disability benefit to supplement a subsequent career at usually a lower salary, would receive nothing under Social Security.

In addition, there are other officers who will not be able to continue to keep performing the duties after reaching middle age, because of the physical and psychological stresses and demands of police work. And therefore they must retire from police work and begin another career. Unfortunately, for these public safety employees, no Social Security benefits will be available, as they start a new career at much less pay.

Social Security death benefits are much lower than current retirement death benefits which often pay anywhere from 50 percent to 75 percent of an officer's salary.

*B. Unintended likely consequences of mandatory Social Security taxes and coverage:*

I would like to discuss the impact of imposing Social Security taxes on these essential workers. Mandating that government agencies and public safety officers each pay 6.2 percent of pay would have a negative repercussion on the retention and recruitment of the highly trained and competent law enforcement officers and firefighters—the most qualified job candidates possible.

Let me explain what is likely to happen to the majority of police and pension systems and to government expenditures if Social Security taxes and coverage are universally mandated.

There seems to be a presumption that governmental bodies can reduce benefits received from current pension plans by the same amount that would be received as benefits by public safety officers under Social Security. First, let us put aside the great disparity between what one receives from a pension plan as compared with Social Security.

As a general proposition, participants in State and local government pension systems have a right to receive retirement benefits at a defined point in the future. These rights are vested by explicit constitutional provisions, statutory provisions, common law contractual rights, or a combination of the above, in all 50 states.<sup>5</sup> In many States, public safety officer retirement benefit levels cannot be reduced without the agreement of both the employer and the employee through collective bargaining or a vote of the citizenry. Therefore, a vested public pension in the majority of states is a contractual or statutory right that can be modified only with some difficulty.

There would be tremendous pressure by government agencies to change these pension systems, pitting public safety officers against elected officials—something none of us wants. But let us assume that most of these current pension systems, which cannot be easily changed, are maintained. A Social Security tax on employees and their government employers would negatively impact public safety operations and could result in layoffs, reduced pay or other benefits, or no cost-of living increases, and could reduce purchases of necessary equipment and technology, or a combination of these consequences. At the outset, this new unfunded Federal mandate would probably inflict on State and local governments reduced staffing or, worse yet, layoffs, or would cause a several percentage point reduction in pay for public safety employees, all based on a 6.2 percent increase in employee personnel costs for local governments.

Let us focus on a somewhat different scenario. There are states, fewer in number, where State governments can change their public pension systems without collective bargaining or votes of the citizens. Facing public pressure against tax increases, the legislatures in these states would likely change the current systems to make them much less beneficial to public safety workers. State and local government pension

<sup>5</sup> A survey of the 50 States, conducted by the National Council on Teacher Retirement, disclosed that 6 States have explicit constitutional provisions guaranteeing pension rights, 15 States have express guarantees in their statutes, 18 States have common law contractual rights, and 11 States approach the issue in other ways (often through a combination of contractual rights and statutory or constitutional provisions). Moore, Cynthia L., *Public Pension Plans: The State Regulatory Framework*, 3rd ed., National Council on Teacher Retirement (to be published in 1998).

contributions to these systems are likely to be reduced, probably dollar-for-dollar for allocation to Social Security taxes.

Those current police and fire pension systems so affected would be severely curtailed. Public safety officers in these plans would therefore have much less protection than they do now, causing police and firefighting work to become much less desirable.

For all of these scenarios, both Congress and the Administration need to ask the following questions: Would we retain the best public safety officers we now have if their take-home pay is automatically cut by 6.2 percent, which is the additional amount that they would have to pay out? Or if Social Security taxes are applied only to new hires, would we recruit the best public safety officers if their take-home pay is automatically reduced by 6.2 percent in taxes? Would we retain or recruit the best officers if current pension systems are severely curtailed—reducing substantially or eliminating excellent early retirement, line-of duty-disability, and early death benefits—so that the total percentage of both employing agency and employee contributions remain about the same, once Social Security taxes are factored in? Would we get the best officers if the employing agency also reduces future pay raises or freezes cost-of-living or other increases, in order to pay its portion of Social Security? I am afraid that the answer to all of these questions would be 'No,' given the tight labor markets and a variety of career choices.

In addition, imposing this tax would negatively affect government expenditures on the best technology and equipment available for law enforcement to fight crime.

In short, mandatory Social Security taxes on law enforcement would hurt efforts to recruit the best qualified and competent law enforcement personnel. It would result in a pool of less qualified candidates for law enforcement positions, with negative implications for public safety.

*C. Additional implications if Social Security taxes and coverage are imposed on only new hires:*

Even expanding the Social Security system to just new hires would cause serious morale problems. It would create a different class of public safety officers and could very well endanger the trust essential among police officers and firefighters depending upon each other in life-threatening situations. If Social Security taxes are imposed on just new hires, it is likely that State and local governments would respond to this added tax burden over time in the same ways and with the same negative consequences for public safety officers and the public safety.

Over time, mandatory coverage on new hires would destroy the early retirement and disability benefits for public safety officers. One might as well abandon many of these individuals and their families if Congress mandates Social Security coverage and thereby causes the States to replace the current pension systems. On the other hand, trying to blend the special needs of actuarially funded pension systems with the structure of Social Security will create substantial complications and costs for benefit design and administration, as well as collective bargaining.<sup>6</sup>

There are other financial implications, as well, if Social Security is applied to new hires. If State and local governments reduce their contributions dollar-for-dollar in new Social Security taxes, current pension systems for grandfathered employees will eventually be severely impacted, as current employees retire with no contributions coming in from government agencies and new workers enter the police and firefighting forces of this country. In effect, Social Security would eventually and inevitably destroy these fire and police pension fund systems. I will describe these potential consequences shortly while discussing the impact on the Detroit police and firefighter pension system.

*D. State tax implications of mandatory coverage:*

For these public safety officer pension systems, there are tax implications which have not been considered. Current retirees receive a benefit which is fully taxed, bringing in revenue to governments at all levels, unlike Social Security payments which are untaxed below a certain income level. Also, closely related, the after-tax income of current public safety officers will be reduced by any shift from pre-tax pension contributions to after-tax Social Security contributions.

*E. Examples of several systems' benefits and probable impact of mandatory coverage:*

To illustrate all of these concerns, I have set forth several examples of the retirement benefits and line-of-duty death and disability benefits available to police offi-

<sup>6</sup>In many States, any government effort to modify current pension systems, either to reduce the contributions or benefits, cannot be unilaterally undertaken without input from workers, but must be the subject of collective bargaining.

cers or their families which Social Security cannot even come close to matching. (My staff surveyed several police and firefighter pension funds in Michigan, Ohio, Florida, and California, and the comments by their officials have been integrated into this statement.)

*Example One: City of Detroit Policemen and Firemen Retirement System.*—This Detroit retirement system has approximately 5,400 active employee members and 7,800 retirees and beneficiaries and over \$3 billion in investments from which to pay benefits. Line-of-duty disability benefits can amount to 66.6 percent of final salary for full disabilities. And employees can retire after 25 years of service, with a retirement set at 62.5 percent of salary, increasing by 2.1 percent for each year after 25 years until 35 years is reached. A line-of-duty death before retirement results in 45.5 percent of the average patrolmen's salary.

Public safety employees are required to contribute 5 percent of salary until eligible for retirement, and in the 1995–96 fiscal year, the City of Detroit had a computed employer contribution of 25.9 percent.

In addition, with an annual average salary of \$40,000 for police officers and firefighters and a total annual payroll (before overtime) of approximately \$220 million, the City of Detroit and public safety officers would have to pay a combined total of at least \$27.2 million in Social Security taxes, if it were made mandatory.

Even if Social Security applies only to new hires, it would be very difficult for the City of Detroit to maintain this system of benefits and salaries for its current public safety employees, as it is required to do under Michigan's constitution (one of 6 state constitutions guaranteeing pension rights). One of two events would likely occur:

First, as other cities have done, Detroit might be tempted to create a second tier system for the new hires, to reduce its contribution by at least the same amount that it would pay into Social Security, 6.2 percent, (if not more). (Presumably this would be done through collective bargaining.) As the number of new hires increases and there are fewer pre-Social Security coverage employees to fund the current system, the system could very well develop unfunded liabilities for those employees already vested in the current system, eventually reducing the amount of funds which can be paid out. There is no way that reducing the City's and employees' contributions to the current system—dollar-for-dollar of Social Security taxes paid—would come close to matching these benefits. Nationally, covering only new hires will eventually hurt hundreds of thousands of current public safety employees, reducing their death, disability, and early retirement benefits, making public safety careers much riskier and less desirable financially.

Or, alternatively, the City may retain the current system for new hires. In that case, as in most large American cities, Detroit will likely pay the 6.2 percent increase for new hires (with the numbers of covered employees increasing every year) by taking it from somewhere else, whether from beginning salaries, new equipment, salary increases for all employees, or retirement health benefits—a particularly vulnerable target, or a combination of these. The most immediate consequences of a 6.2 percent tax would likely be a significant decrease in a new-hire's salary and reductions in health insurance for retirees or other benefits. Do not have any doubts; this is what would happen!

An official for the Detroit fire and police pension system told us during an informal NAPO survey, "We have 50 years or more of success and a history of serving our police officers and firemen. Why would the Federal government want to disrupt this healthy and fine-tuned system?" That sentiment was mirrored by others.

*Example Two: Ohio Police and Fire Disability and Pension Fund.*—The Ohio Police and Fire Disability and Pension Fund serves 25,000 members and 15,000 retirees or surviving beneficiaries.

Approximately 25 percent of all police and fire retirements are due to full or partial disability occurring in the line-of-duty, which is not an unusual number. Full disability results in payments to the officer at 75 percent of active duty salary in this statewide system, and partial disabilities (79 percent of police and fire disability retirements overall) results in disability awards ranging from 5 percent to 60 percent of salary. As compared with this system, Social Security would provide no benefits to these individuals, unless they were totally unemployable in any line of work. And, even if they were so unemployable, the benefit would be a fraction of what these officers currently receive in disability pay. In addition, line-of-duty death benefits replace all of an officer's income and are available for the public safety officer's survivors; the Social Security benefit is significantly lower.

Employees contribute 10 percent of their pay, and State agencies pay 19.5 percent of pay for police officers and 24 percent of pay for firemen. To retain the same benefits and to impose Social Security would result in employees paying 16.2 percent of



pay and municipalities paying 25.7 percent for police and 30.2 percent for firefighters, a heavy burden.

Also, if Social Security taxes were imposed on all active police and fire personnel, then Ohio municipalities would have to pay an additional \$68.2 million (based on a payroll in FY 1996 of \$1.1 billion) for public safety officers alone.

As the head of this Ohio pension fund has said, "Our workers will be giving up the certainty of an actuarially funded pension for the uncertainty of a pay-as-you-go plan with an unreachable age for retirement and a very-hard-to-reach requirement for eligibility for disability benefits."

*Example Three: City of Tampa Pension Fund for Firefighters and Police Officers.*—The Tampa City Pension Fund for Firefighters and Police Officers has 1,411 active contributing public safety officers and 1,205 retired members and beneficiaries, as of October 1997. Officers can receive up to 65 percent of salary for line-of-duty disabilities, regardless of age. They can retire after 20 years at age 46 with a pension at 50 percent of salary (increasing for later retirement). For a death benefit, a surviving spouse receives 65 percent of the member's earned benefit, plus cost-of-living increases.

The City contributes 7.7 percent of salary, and employees contribute 5.75 percent of salary into this retirement system. The system is very healthy financially, and its investments, mostly in equities, have returned an average annualized return to 15 percent, making these benefits possible.

A pension fund official told us that if Social Security taxes were imposed on new police officers and firefighters in this system, it would be necessary to continue the current system to maintain the same level of benefits, to fill in the gaps prior to age 62 or 65. If coverage were made mandatory for all public safety officers, based on 1996 payroll figures of \$66.5 million, the city would pay \$4.1 million, and employees would pay the same amount, resulting in a significant reduction in pay. Yet, even if coverage applied to just new hires, the likely consequence of superimposing a 6.2 percent tax on employee and employer would be to reduce the number of firefighters and police officers serving Tampa's citizens or significantly reduced benefits for these employees, or a combination of both.

By contrast, there is the statewide Florida Retirement Systems, which includes a system for 'special risk' members, including all Florida county firefighters and deputy sheriffs. Members of this system are also covered by Social Security. Employing agency contributions equal a whopping 32.6 percent—26.4 percent for the pension system and 6.2 percent for Social Security. Interestingly, the benefits are not nearly as beneficial as Tampa's system. To recover disability, public safety officers must be unable to hold any substantial gainful employment and officers cannot retire under age 55. Therefore, even with a greater outlay of funds, the Florida State system cannot provide nearly the same security and benefits essential to attract and keep police officers, as does the Tampa system.

*Example Four: City of Los Angeles, The Safety Members' Pension Plan.*—In the City of Los Angeles, there are over 12,000 active public safety officers contributing to the Safety Member's Pension Plan or an earlier pension plan for those hired prior to 1980 (the vast majority of firefighters and police officers are in the Safety Members Pension Plan). In addition, there are 11,049 individuals receiving a service, disability, or survivor pension.

Public safety officers hired between 1980 and June 30, 1997, belong to Plan I. Those hired since June 30th are members of Plan II. Plan I members can retire at age 50, with a minimum of 10 years of service. Plan II members can retire at any age with at least 20 years of service. In all other aspects, the plans are the same. The amount of the pension will vary from 20 percent of final average salary after 10 years, to 55 percent of salary after 25 years, to 70 percent of salary after 30 years. Service-connected disabled members receive 30 to 90 percent of average salary, depending on the degree of disability. A service-connected death qualifies a survivor for a benefit at 75% of the member's final average salary.

The active members contribute 8 percent of their salary, and the City contributes approximately 15 percent of salary (which varies from year to year), for an approximate total of 23 percent. At the end of FY 1996, the Pension Plan's investments were valued at \$6 billion, and the rate of return for that year was 14.6% percent.<sup>7</sup>

<sup>7</sup>Section 535 of the City's Charter provides that, should Social Security be mandatory, the City will integrate the Social Security benefits with the Safety Members Pension Plan, so that benefits are "at least equal to the benefit offered by the Safety Members Pension Plan prior to such integration." (p.678, Charter of the City of Los Angeles, Rev. 12-13-90)

#### IV. CONCLUSION: IMPACT OF MANDATORY SOCIAL SECURITY ON PUBLIC SAFETY OFFICERS

In conclusion, keep in mind these essential points: Social Security does not address the special needs of police officers and firefighters. First, they and their families need the security of service-connected disability and death benefits. Social Security benefits do not provide anywhere near the same level of benefits, and, in fact, provide no disability benefits unless one is totally unable to perform any work, not just public safety work.

Second, Social Security is not appropriate for public safety officers who normally retire prior to or around 55 years of age, as usually they must, due to the stresses and dangers faced every day. Social Security will pay these individuals nothing, until they reach 65 (unless they take a reduced benefit at age 62).

Even mandating Social Security taxes on just new police officers and firefighters will seriously disrupt compensation and benefits for all of them. From our perspective, it makes no sense whatsoever to harm a system of pension funds that is working well and paying needed benefits to those who protect the public safety through public service. Forcing State and local governments and employees to pay a combined 12.4 percent tax will have major consequences.

Scaling back and reducing the benefits in the current plans, even if done only for new hires, would reduce and could potentially eliminate these crucial benefits paid to these officers in recognition that they repeatedly put their lives on the line and are often disabled at some point in their careers. This would be the consequence of reducing employer and employee contributions to current pension plans in order to pay Social Security taxes.

For those remaining State and local governments which will both pay the 6.2 percent tax and retain their current pension systems for everyone, there will still be serious consequences to both pay and working conditions. This is because the money to pay the tax has to come from somewhere, and raising taxes or pay to make up the difference is not politically feasible. As a result, first, officers will automatically suffer a minimum de facto pay decrease through the newly imposed 6.2 percent tax, in order for them to keep their current pension benefits. Second, either local governments will reduce the number of public safety officers to retain current pay levels and benefits, or they will reduce the pay of law enforcement officers or freeze future cost-of-living increases. Also, to minimize the impact on pay, it is probable that government bodies will not provide public safety officers with the essential equipment (such as bulletproof vests) and technology needed to effectively perform their work.

Under a mandatory Social Security system, police officers and firefighters will pay more taxes for inadequate benefits. Their ability, through collective bargaining and the political process, to obtain what they need to compensate them for their service to us, the public, will be severely weakened. Even if limited to new hires, the consequences of mandatory Social Security taxes—lowering benefits or salaries and freezing cost-of-living increases—will make police and fire safety work less financially desirable. If we tamper with the current system, we will most assuredly lose some of our better candidates and current officers to other professions, in view of the fierce competition among police departments and the private sector.

Mandatory Social Security taxes and coverage will hurt, not help, 75 percent of the public safety officers not included, in addition to millions of other public employees. It will hurt us all.

#### V. NEED FOR PROPOSED LEGISLATION TO WEP AND GPO

I would also like to briefly touch on two Social Security provisions that the Subcommittee on Social Security will be addressing in this hearing. These two provisions, the Government Pension Offset (GPO) and Windfall Elimination Provision (WEP), affect the way benefits are calculated for retirees of Federal, State and local governments, who do not pay into Social Security. The GPO was instituted in 1977 and later amended in 1983, to set a two-thirds offset for Social Security benefits of spouses or surviving spouses earning government pensions. The WEP was adopted as part of the Social Security Amendments of 1983, which affect an individual's Social Security if that person becomes eligible for a Federal, State or local government pension after 1985, based on work not covered by Social Security.

In present form, the GPO and WEP unfairly over-penalize employees who participate in government pension plans in lieu of Social Security. NAPO believes that there must be some equity when lawmakers distinguish between pensions earned in the private sector and those in the public sector. Currently, there is legislation pending in the 105th Congress correcting these inequities, which we strongly support.

As part of the CARE coalition (Coalition to Assure Retirement Equity), NAPO has been actively lobbying to ensure that the concerns of public employees are met. This legislation would not repeal the GPO or WEP but would appropriately amend the provisions. I recognize the fiscal and budget considerations which would arise from such a repeal. However, I also recognize that law enforcement and other government employees who do not pay into Social Security should not be used as tools to facilitate the solvency of the Social Security program. The modified legislative proposals addressing these issues are, as follows.

On July 25, 1997, Congressman William Jefferson (D-LA) introduced H.R. 2273 to amend the Government Pension Offset. Congressman Jefferson's bill would remove the offset for anyone whose combined monthly benefit from a government pension and a spouse's Social Security benefit is \$1,200 or less. On November 4, 1997, Senator Barbara Mikulski introduced S.1365, a companion bill, with some modifications. Her bill would provide for an index adjustment for the \$1,200 threshold, due to the cost of living. Also, Senator Mikulski's bill would initiate the two-thirds offset for anything over \$1,200, compared to a dollar-for-dollar offset in Congressman Jefferson's bill.

On September 25, 1997, Congressman Barney Frank (D-MA) introduced H.R. 2549 to amend the Windfall Elimination Provision. This bill would amend Title II of the Social Security Act. Under this bill, individuals whose combined monthly government pension and Social Security benefits are \$2,000 or less would be exempt from the WEP. The WEP would then be phased in for amounts between \$2,000 and \$3,000, and, if over \$3,000, the full WEP would apply.

It is estimated that 500,000 government retirees have already been affected by the GPO (\$210,000) and WEP (\$290,000). These provisions will financially impact many more low- to middle-income government employees in the future. As stated before, many law enforcement employees retire early due to the nature of their jobs. Subsequently, many will enter the private sector and earn enough credits to qualify for Social Security. These individuals will become greatly impacted by the WEP formula because of their short, or fairly evenly split careers, compared to workers with long-covered Social Security jobs.

The GPO has a profound effect on the economic security of a widow (or widower), who receives a government pension and relies on the full payment of their widow's benefit of Social Security. The law unfairly offsets a recipient whose pension was not covered by Social Security and exempts individuals who earned their pension in the private sector. Furthermore, public pensions are taxed, while Social Security is not if income falls below a certain amount, which adds to the host of inequities facing many public sector workers. It should be noted again that an estimated 75 percent of law enforcement employees do not pay into Social Security.

Thank you for the opportunity to submit a statement for the record.

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#### **Statement of National Committee to Preserve Social Security and Medicare**

Chairman Bunning, Members of the Subcommittee on Social Security, we appreciate your holding this hearing to review anti-windfall provisions of Social Security law. We welcome this opportunity to submit testimony regarding proposed reforms to Social Security to lessen any inappropriate adverse impact on Government employees who are covered under retirement systems which are outside of the Social Security system. On behalf of the 5.5 million Members and supporters of the National Committee to Preserve Social Security and Medicare we appreciate the importance of this series of hearings, and its contribution to the unfolding national dialogue.

We especially appreciate your willingness to include testimony in this particular hearing about how the Government Pension Offset (GPO) and Windfall Elimination Provisions (WEP) of Social Security can unfairly impact low earners. Our testimony will focus on these issues, as well as issues related to disability coverage of Government annuitants. We will also comment on proposals to bring currently non-covered government employees into the Social Security System.

Mr. Chairman, as you know, federal, state, and local workers receiving retirement or disability benefits for government employment which was not covered by Social Security, also may be eligible for Social Security based on their own or a spouse's employment. In recent years, Congress has reduced Social Security benefits to such individuals, arguing that government annuitants frequently received higher Social Security benefits in relation to contributions than individuals who worked solely under Social Security. Some of these reductions are excessive and inequitable.

For example, 64 year old Mrs. Ruth Shoup of Florida, is a victim of a double offset. She is affected by both the GPO and WEP. Her late husband, a retired policeman, paid into Social Security all of his life. Mrs. Shoup also worked all of her life, for about 20 years in the private sector and about 21 years with the Postal Service. After her husband's death, Mrs. Shoup was forced into early retirement due to rheumatoid arthritis. When she applied for Social Security widow benefits she was told that the offset essentially eliminated any benefits to which she might be otherwise entitled. Despite her husband's life-long contributions to Social Security and her own for about 20 years, she has been told that when she turns 65 she'll probably only see an extra \$50 per month from Social Security. She lives on \$950 per month after taxes and her health insurance premium. When Mrs. Shoup becomes eligible for Medicare her \$50 per month health coverage, including her coverage for prescription drugs, will terminate. After two operations on her hands, Mrs. Shoup's medical bills are mounting. Ironically, because of the offset and windfall elimination, Mrs. Shoup may be eligible for Medicare premium assistance when she turns 65.

Mr. Cornelius Faass, also of Florida, is 67 years old. He worked until almost 3 years ago, mostly part time since he started his Social Security at age 62. In December of 1995, Mr. Faass began receiving a pension from Holland where he worked as a Merchant Marine before acquiring U.S. citizenship in 1962. The Dutch pension is about \$175 to \$200 per month depending upon the current exchange rate. Since January, because of the GPO, SSA has been taking \$123 per month from his Social Security due to the pension. Mr. Faass was receiving Medicaid food stamp assistance of \$90 per month until the pension came. Then his food stamps were dropped to \$77 per month and eventually revoked entirely last July. In November, his food stamp assistance was reinstated to \$32 per month.

#### GOVERNMENT PENSION OFFSET

Under the Government Pension Offset, a government annuitant may receive only that portion of a Social Security spouse or widow benefit which exceeds two-thirds of the government pension. No one but a government annuitant suffers a loss of Social Security due to receipt of a pension. Spouse and survivor benefits are not denied to persons receiving other, comparable non-Social Security annuities.

Frequently, the offset totally eliminates a Social Security benefit a spouse or widow relied upon receiving. The National Committee, a long standing member of the Coalition to Assure Retirement Equity (CARE), supports modification of the offset to lessen its severity. We commend your colleagues Congressman William Jefferson and Senator Barbara Mikulski for introducing legislation, H.R. 2273 and S.1365, to alleviate the problem. This legislation would protect many low-income women, in particular from excessive reductions. We urge you to enact such legislation this year and to include the Mikulski language which ensures that the proposed \$1,200 threshold for the offset will be regularly adjusted for inflation, and that also ensure no one receives an inadvertent reduction in benefits as a result of any change enacted.

#### WINDFALL ELIMINATION

Under Windfall Elimination, Social Security Benefits are reduced for a worker who personally earns both a government pension and a Social Security benefit from separate employment unless the worker has 30 or more years of Social Security employment. The maximum reduction applies to a worker with 20 or fewer years of Social Security employment and can be as much as half the government pension. Hardest hit by this provision are workers with careers roughly evenly divided between covered and non-covered employment. Phasing the reduction over more years, for example by using a 2.5 percent reduction in the first bend point for each year less than 30, would provide a more equitable benefit to workers with significant years of Social Security employment.

Because government pension plans provide proportionately smaller pensions to short service workers, a worker with a divided career has the worst of both worlds. The government pension is proportionately less than it would be for a full government career and Social Security can be reduced by as much as 55.5 percent.

The 90 percent replacement rate in the first bend point of the Social Security benefit determination method was deliberately designed to weigh benefits so as to give added protection to low and average earners. The Windfall Elimination Provision, by its across-the-board reduction to 40 percent of the first bend point, regardless of the wage earner's level of earnings, frustrates that purpose. The low earner is deprived of the protection intended by the law in order to make certain no high earner is overcompensated. This unintended penalty on low earners and those with lifetime

modest wages could be minimized by limiting the Social Security windfall reduction to a smaller proportion of the pension received from non-Social Security covered employment as has been suggested by former Social Security Actuary Robert J. Myers.

#### DISABILITY BENEFIT GAP

A requirement for Social Security Disability insurance benefits is earnings in at least five of the ten years before becoming disabled. The purpose of this "recency of work" test is to limit benefits to persons who are out of the work force because of disability. However, only Social Security earnings count. Government employment is treated as if the individual was unemployed. Workers who move between Social Security covered employment and non-Social Security covered employment thus can be deprived of disability benefit protection without ever having missed a day of work. The recency of work test should recognize all employment. Windfall elimination and the Social Security disability benefit formula are adequate safeguards against excessive benefits.

#### DISABILITY BENEFIT CAP

A separate provision of law effectively denies Social Security disability benefits to anyone working two jobs, one in Social Security covered employment and the second in non-Social Security employment. Combined disability benefits are capped at 80 percent of pre-disability Social Security earnings alone. Government earnings are ignored in setting the 80 percent cap, but government benefits count against the cap. Total earnings should be the basis for the 80 percent cap.

There is historic precedent for recognizing and protecting the worker's total earnings from loss of earnings due to disability. When an 80 percent disability benefit cap was initially placed on Social Security earnings in the early 1970s, only earnings on which Social Security FICA taxes had been paid were considered. Workers with earnings over the taxable wage base had no protection for their higher income above the wage base. Within four years, Congress recognized this inequity and revised the law. The disability benefit cap was re-established as 80 percent of earnings in covered employment, thereby protecting the worker's entire income. Individuals working two jobs deserve this same recognition of total earnings in capping combined disability benefits.

#### MOVING NON-COVERED WORKERS INTO SOCIAL SECURITY

All of the problems and inequities discussed in this testimony would become a thing of the past if Social Security were universal as has been consistently advocated by the National Committee. Until that goal is achieved, we are appreciative of the efforts of this Committee to ensure that Social Security reductions imposed on persons with non-covered pensions do not go beyond Congress' intent to eliminate only inappropriate excess benefits.

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NATIONAL CONFERENCE ON PUBLIC  
EMPLOYEE RETIREMENT SYSTEMS (NCPERS)  
*May 26, 1998*

The Honorable Jim Bunning, Chairman  
Subcommittee on Social Security  
Committee on Ways and Means  
*U.S. House of Representatives*

Dear Chairman Bunning:

I am writing to you on behalf of The National Conference on Public Employee Retirement Systems (NCPERS) to urge you not to support legislation that would reform Social Security by mandating coverage for public employees. Currently there are several bills that have been introduced in the House that are designed to keep Social Security solvent. All of these bills have one thing in common, mandatory coverage of public employees by the Social Security System. We strongly oppose such a provision because it would have a profoundly negative affect on our members and their beneficiaries.

NCPERS is a powerful pension advocacy partnership with 450 fund members from all 50 states, representing more than \$750 billion in assets and more than 5 million public employees and retirees.

While 80 percent of our members are already covered by the Social Security program, we are still opposed to mandatory coverage because we believe that it is unfair to those funds who are not currently in the system. Many of our members were not allowed to participate in the program when Social Security was first introduced. They were then forced to start their own retirement plans. Additionally, many of our members have retirement funds that pre-date the creation of Social Security. Forcing them to join the Social Security program at this point would be very costly both for public employees and state and local governments for the following reasons:

- It would be costly to retirement programs. Making Social Security mandatory would have little impact on the projected funding shortfalls of Social Security, however, such a move would greatly affect public employees. Public employees currently not covered would be required to pay an additional 6.2% in payroll taxes.
- It would be costly to states and localities. As employers, states and localities would also be required to pay an additional 6.2% in payroll taxes. This would cost California over \$2.3 billion annually, Ohio \$1 billion annually, and hundreds of millions to Texas, Illinois, Colorado, Massachusetts and Louisiana.
- It would be disruptive to existing retirement programs. Many public employers would be unable to absorb the higher costs. They would be required, in addition to the Social Security payroll tax, to continue the funding of their respective retirement plans. Many of these plans are established constitutionally and to make such a change would require legislative action and/or a constitutional amendment.
- It would require the creation of a second tier. A second tier of retirement benefits would have to be created for prospective employees required to be covered by Social Security.

NCPERS acknowledges the arguments of proponents of mandatory Social Security coverage, that everyone should be covered by Social Security to reduce public assistance costs. However, these proponents fail to note the existence of properly funded state and local government retirement plans also reduce the cost of public relief. They also argue that public employees who are not covered by Social Security often get benefits from a spouse or through other employment covered by Social Security. This issue was already addressed by Congress in the 1983 "anti-windfall" legislation that was passed to reduce the Social Security benefit of such employees.

Although we are aware that specific action on this issue will not take place for the remainder of this session, a number of hearings are already scheduled, as well as the SAVER Summit and other forums for you and Congress to begin the process of debate. We feel it is important for us to communicate with you our position for what is anticipated to be a legislatively charged issue in the next Congress.

I urge you to oppose any provision to extend mandatory Social Security coverage of public employees. Such a law would be detrimental to the millions of uncovered public employees and their employers.

Sincerely,

JAY W. BIXBY  
*President*

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NATIONAL CONFERENCE OF STATE LEGISLATURES  
WASHINGTON, DC 20001  
May 20, 1998

The Honorable Jim Bunning, Chairman  
Subcommittee on Social Security  
Committee on Ways and Means  
U.S. House of Representatives

Dear Chairman Bunning:

On behalf of the National Conference of State Legislatures I urge you to oppose efforts to extend Mandatory Social Security Coverage to all newly hired State and local employees.

The subcommittee's hearing on May 21, 1998, "The Future of Social Security for this Generation and the Next," is expected to highlight the devastating effects such a change would have on state finances. While the number of covered State and local workers has remained consistent at 70%, future efforts by the federal government to expand mandatory coverage would have severe consequences for states with large numbers of uncovered employees and would constitute a tremendous cost shift to states. NCSL firmly opposes all efforts by the federal government to extend mandatory coverage to additional categories of state and local employees.

In 1991, NCSL opposed final OBRA 1990 regulations and revenue procedures mandating full Social Security coverage, including Medicare, for public sector employees who are not members of a retirement system. The final rule required public employee retirement systems to meet minimum contribution and benefit level standards, and also required that part-time, seasonal and temporary (PST) employees be immediately and fully vested (100 percent) in any employer-sponsored retirement arrangement in order to satisfy the rules. The mandate disproportionately affected approximately 3.8 million State and local employees who were part-time, seasonal and temporary employees—the very employees least able to pay the tax increase on their income resulting from mandatory coverage.

NCSL maintains that the U.S. Department of Treasury and the IRS went well beyond the intent of OBRA 1990 in their interpretation of the law. At the time of the final rule, NCSL feared that the action would make it easier for the federal government to become further involved in the administration of state and local public plans and to expand mandatory Social Security coverage to all state and local public employees. Presently, it appears that the Congress intends to consider these proposals as possible revenue generators.

State and local retirement plans do an excellent job of providing for the retirement of public employees. Rather than extending the unfunded mandate, NCSL urges the Congress and the administration to grandfather preexisting state and local retirement plans. In other words, public plans in existence prior to the adoption of OBRA 1990 (November 5, 1990) would be deemed in compliance with the law and benefits received from a state or local retirement system would qualify as being equivalent to a benefit received under Social Security.

NCSL opposes any additional involvement of the federal government in public pension plans and the expansion of mandatory Social Security coverage for public employees of state and local governments who are not already covered. NCSL believes that state and local governments should be allowed to affiliate their plans with Social Security on a voluntary basis.

We look forward to working with you further on this issue. If our staff can be of any assistance to you, please do not hesitate to contact Chris Zimmerman, our Federal Budget and Tax Committee Director at (202) 624-8668 or Gerri Madrid, our Fiscal Policy Associate at (202) 624-8670.

Sincerely,

TOM JOHNSON, CHAIR  
Federal Budget and Taxation Committee  
Ohio House of Representatives

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#### **Statement of Russell Graves, President 1997-98, National Conference of State Social Security Administrators**

The National Conference of State Social Security Administrators (NCSSSA) represents more than 70,000 state and local government employers nationwide. These comments concern a major issue that has arisen in recent proposals regarding mandated social security coverage for all newly-hired state and local government employees.

It may seem somewhat ironic that the NCSSSA, which has been given the statutory authority in all 50 states, including several U. S. territories, to serve as the liaison between the federal Social Security Administration and the state and local units of government, would come out and oppose a proposal for universal Social Security coverage. An in depth explanation of the respective roles of the State Social Security Administrator, the NCSSSA as an organization, and the Social Security Administration would be in order, and, as such, follows:

The exception from social security coverage for state and local government employees was included in the original version of the Social Security Act (HR 7260), approved in 1935. The committee reports on the act contain no discussion of the exception provision. In the January 22, 1935, hearings of the Committee of Ways and Means, however, Dr. E. E. Witte, Executive Director of the Committee on Economic Security, was quoted as saying:

"Government employees are excluded from the tax for obvious reasons. The federal government cannot impose a tax on the states or the political subdivisions of the states. This is a tax measure..."

The 1950 amendments to the act, effective January 1, 1951, allow a state to enter into a voluntary agreement with the Social Security Administration and permit the state and its political subdivisions to provide social security coverage for their em-

employees. Section 218 of the Social Security Act includes this voluntary coverage concept.

The Omnibus Budget Reconciliation Act of 1990 (OBRA 90) requires social security coverage for every state and local government employee who does not belong to a qualified, public retirement plan or not covered by social security under a Section 218 agreement. OBRA 90 retains the states' and their political subdivisions' right to determine whether employees are covered by social security or a public retirement plan that provides comparable, but in most cases greater, benefits. Although public employers have managed to comply with the coverage requirements of OBRA 90, it has only been with significant expense and great administrative effort. And though the cost is great, every state and local governmental employee has some form of retirement protection.

Aside from the obvious question of constitutionality, the imposition of universal social security coverage would cause havoc on the organization of many state retirement systems. The cost of universal social security to state and local government employers would be devastating. States in which there is limited Social Security, such as California, Colorado, Illinois, Louisiana, Massachusetts, Ohio and Texas, would face overwhelming burdens on already strained budgets. Even states that already have general social security coverage for their public employees (Connecticut, Florida, Kentucky and Michigan to name a few) would have thousands of employees impacted and millions of tax dollars in costs as universal coverage is phased in. Some public retirement systems were created prior to 1951 specifically for certain career employees, such as teachers, police and firefighters, when social security coverage was not available to public employees. These non-social security retirement systems were designed to provide their members with a complete benefit structure of retirement, disability and survivors coverage that was based on the unavailability of social security coverage.

The imposition of the "new hire" rule places public retirement systems in the position of having to review all the pension plans for their affected employees. Sound pension policy dictates that states must consider the issue of equity to its employees, as well as the reasonableness of the income replacement at retirement. If new-hires retain the benefits of current pension plans, then they would be entitled to a significantly higher level of income replacement at the time of retirement (current pension benefits plus social security), at a significantly higher cost to the taxpayers. States cannot justify paying higher benefits simply because of the hire date of an employee. These states would be forced to either increase the benefits of current "old hires" in the interest of equity or to establish new retirement systems or new tiers for the new hires with equivalent total income replacement values. This process of creating an entirely new retirement system for a new class of employees requires legislative and policy considerations that cannot simply be accomplished with a stroke of a pen.

The economics of establishing a separate system for the new hires could undermine the actuarial soundness of the old system due to the loss of new members contributions to the system. A two-tier system would likely lead to further legislative pressures to increase benefits or to expensive lawsuits brought by either of the employee groups.

It has been said that the "new-hire" proposal would ease the administrative burden of the social security program for the Internal Revenue Service and the Social Security Administration. One only has to examine current medicare coverage with its new-hire provisions to realize that it is very complicated and requires additional and constant administration by both the state and local employers and the federal agencies.

It is somewhat surprising and, perhaps even more alarming, that Chairman Bunning was quoted as saying "...To many, covering those State and local government workers not covered under Social Security is an issue of simple fairness...". "Simple fairness" seems like a very frivolous reason to change a well established public pension policy for nearly 5.0 million government workers. In fact, based upon the original language in the Social Security Act, which excluded state and local government employees from participating in the program, quite the opposite would seem to fit under the general category of "simple fairness."

Requiring all newly hired state and local government employees to participate in the federal program will cause financial hardships to the various affected employers. Actuarial costs such as the employer's share of retirement contributions to the existing plans will be significantly increased. This will occur because newly hired employees will, in all likelihood, be contributing at an employee contribution typically one-half of the non-covered employees. For the next fifteen to twenty years, at a minimum, the public plans will continue to have to pay retirement benefits to "old hires" at the rates in effect when they established service credit, however, the



amount of revenues available to the pension fund has now been reduced because of lower "new-hire" employee contributions.

This income gap between benefit payout and employee contributions paid in could have potentially three disastrous effects. First, it may force the pension fund to seek higher rates of returns by investing in more volatile and highly speculative types of investments. One needs only to recall the financial horror stories such as those in one county in a western state and others like it to see the results of an overly aggressive investment policy. Second, the required employer contribution could become so high that, when faced with tax caps in some localities and states, the employing entity will be forced to choose which types of service will be reduced or simply deleted altogether in order to pay the higher employer contribution rate, as well as the required matching share of the Social Security contributions. Third, situations will arise when a "newly-hired" employee working side-by-side with an "old-hire," faces the unfortunate truth of having to work perhaps as many as five or seven more years to enjoy the full complement of retirement benefits from both the federal and state (or local) governments to which they are entitled. This is based upon many non-covered public retirement plans which have a "normal" retirement age of 60, as compared to an ever-escalating age for unreduced Social Security benefits (presently up to nearly age 70).

In the event this proposal becomes law, Section 218 must remain in place to ensure that details of social security for the employees continue under the existing Section 218 Agreements. State and local governmental employers also need the avenues Section 218 provides to allow for social security coverage of veteran ("old-hire") employees, if they so desire, as in current medicare-only coverage.

Imposition of universal coverage would impair, and in some cases severely lessen, retirement security for millions of state and local government employees. Government pension plans work well for employees because returns on investments allow the employees to receive substantially greater benefits than would be possible under an incremental approach. Public pension funds are invested directly in the economy, thereby creating jobs and earning dividends that help fund future retirement benefits.

The NCSSSA requests that serious consideration be given to all of the ramifications of universal social security coverage. We propose that perhaps an alternative be given to expanding certain existing voluntary coverage provisions, such as extending the option to divide retirement systems on the basis of desire for coverage, to all states (Social Security Act Section 218 (d)).

We believe the human and monetary costs to state and local governments of universal social security, at this time, far outweigh the benefit of any revenue to be gained by the federal government.

The NCSSSA appreciates the opportunity to express our position on this matter of national interest. If you have any questions or would require additional information from the NCSSSA, please contact me (405) 521-3555.

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#### **Statement of the National Education Association**

Mr. Chairman and Members of the Subcommittee:

On behalf of the 2.3 million teachers and other education employees who are members of the National Education Association (NEA), we would like to thank you for the opportunity to address the subcommittee about Social Security reform.

We would like to address two issues: the government pension offset provision and mandatory Social Security coverage. NEA strongly supports scaling back the pension offset provision, which requires the reduction of Social Security benefits to thousands of retirees whose public employer does not participate in Social Security, but who are otherwise entitled to Social Security benefits based on their spouses' private sector employment. The provision's current two-thirds reduction in spousal benefits severely limits the retirement benefits of retired public employees.

On the issue of mandatory participation in the Social Security program, NEA opposes such a requirement because it would weaken current pension plan benefits for public sector retirees. It would also impose unfunded mandates on fiscally overburdened state and local governments.

#### **GOVERNMENT PENSION OFFSET**

When the Social Security system was established in 1935, state and local government employees were excluded from coverage. In the 1960s, these employees were given the opportunity to elect to participate in the Social Security system. As a re-

sult, public sector employees in 36 states opted to enroll in Social Security in the 1960s and 1970s. The remaining 13 states and a number of local governments in two others chose instead to maintain and enhance their existing retirement systems.

The government pension offset affects government employees and retirees in virtually every state, but its impact is most acute in 15 states. They are Alaska, California, Colorado, Connecticut, Georgia (certain local governments), Illinois, Louisiana, Kentucky (certain local governments), Maine, Massachusetts, Missouri, Nevada, Ohio, Rhode Island, and Texas. Nationwide, more than one-third of teachers and education employees and more than one-fifth of other public employees are not covered by Social Security.

In 1977, federal legislation was enacted that required a dollar-for-dollar reduction of Social Security spousal benefits to public employees and retired public employees who received earned benefits from a federal, state, or local retirement system. Following a major campaign to repeal the provisions, Congress and the President agreed in 1983 to limit the spousal benefits reduction to two-thirds of a public employee's retirement system benefits. But this remedial step falls well short of addressing the inequity of Social Security benefits between public and private employees.

The harshest affects of the offset provision are borne by lower-income women. It is estimated that the spousal benefit is eliminated entirely in 9 of 10 cases, even though the covered spouse paid Social Security taxes for many years, thereby earning the right to these benefits. Moreover, these estimates do not capture those public employees or retirees who never applied for spousal benefits because they were informed they were ineligible.

According to the Congressional Budget Office, the government pension offset reduces benefits for some 200,000 individuals by more than \$3,600 a year. Ironically, the loss of these benefits may cause these women and men to become eligible for more costly assistance, such as food stamps.

The present system creates a tremendous inequity in the distribution of Social Security benefits. The standard for this narrow class of individuals—retired public employees who are surviving spouses of retirees covered by Social Security—is inconsistent with the overall provisions of the Social Security Act and does not apply to persons receiving private pension benefits. This imbalance exists even though Congress, through ERISA standards and tax code provisions, has more direct influence over private employers than public employers.

#### *Three Personal Illustrations of How the Offset Provision Harms People*

- A retired widow who worked as a custodian in the Parma, Ohio, public schools receives just \$215 a month from the Ohio School Employees Retirement System. Her Social Security spousal benefit is reduced to \$215 a month after applying the government pension offset provision.
- A disabled former school employee and widow who retired in 1986 receives \$403 a month from her school pension. That income totally offsets a \$216 per month Social Security survivor's benefit. Her total income is about 70 percent of the federal poverty level.
- A retired widow who worked as a school cook receives \$233 a month from her school pension. Her Social Security widow's benefit is reduced by \$155 because of the automatic offset. Her combined total income is about 76 percent of the federal poverty level.

NEA supports H.R. 2273, legislation sponsored by Representatives William Jefferson (D-LA) and J.D. Hayworth (R-AZ), that would amend Title II of the Social Security Act to protect low-and middle-income public retirees by limiting the government pension offset. H.R. 2273 and companion bill S. 1365, sponsored by Senator Barbara Mikulski (D-MD), would also move to restore equity between public and private employees in the distribution of Social Security benefits.

#### MANDATORY SOCIAL SECURITY PARTICIPATION

NEA believes that requiring state and local employees to participate in the Social Security system is unnecessary and financially burdensome. A federal mandate for participation will not solve the systems' financial difficulties and would weaken state and local plans whose benefits are superior to those provided by Social Security.

The 15 states that have opted not to participate in the Social Security system have strong plans that provide ancillary benefits such as health care, disability and survivor coverage and secure portability. These ancillary benefits would have to be lowered or eliminated if non-participating pension systems are required to pay Social Security.

Mandatory participation would also create unnecessary and burdensome financial burdens for the state and city governments involved, as well as hurt active and retired employees. If these governments are required to pay the full cost of the FICA tax, this could result in diluted benefits to retirees and fewer funds available for investment, a large source of income for the affected pension plans.

We urge you to support H.R. 2273, which moves to restore eligibility for mostly lower-income survivors of spouses who paid into the Social Security system, and to reject mandatory Social Security participation. Teachers and other public employees who have devoted their working lives to children and public service should not have to worry about the security of their retirement plans.

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**Statement of Robert M. Tobias, National President, National Treasury Employees Union**

Chairman Bunning, Members of the Subcommittee:

I am Robert M. Tobias, National President of the National Treasury Employees Union (NTEU). Thank you very much for holding this timely hearing today and for giving us an opportunity to present our members' views on the effects of the Government Pension Offset (GPO).

NTEU represents over 160,000 federal employees and retirees. Many of our members have already felt the effects of the Government Pension Offset. Others are not yet aware of the impact this offset could have on their retirement income. Federal retirees often first become aware of the existence of this offset at the time they first apply for Social Security benefits.

As you know, the Government Pension Offset reduces or eliminates the Social Security benefit many federal retirees are otherwise eligible for on their spouse's earnings record. Under current law, Social Security benefits normally due an individual as a spouse or widow of a Social Security recipient, are reduced by two-thirds of the amount of the government pension.

For example, if an elderly widow is eligible for a monthly pension of \$600 as a result of her federal government service, two-thirds of that amount, or \$400, must be used to offset the Social Security spouse's or widow's benefit for which she might also be eligible. If she is eligible for a monthly spousal Social Security benefit of \$500 based on her husband's earnings record, the GPO results in her receiving only \$100 per month. This is not an isolated example.

More often than not, this offset disproportionately affects those who can least afford to forego this retirement income. The effects are particularly devastating to female federal employees who are often eligible for only meager federal pensions resulting from either interruptions in their careers while raising their families or working in lower graded positions for most of their careers. Had these individuals toiled in the private sector earning private pension benefits instead of dedicating their careers to public service, they would remain fully eligible to collect their spousal Social Security benefits.

NTEU strongly supports legislation introduced by Congressman William Jefferson (D-LA), H.R. 2273. While this legislation would not entirely eliminate the GPO, it represents a humane step in the right direction by applying the GPO only to combined annuity and Social Security spousal benefits that exceed \$1200 per month. One hundred and sixty two of Congressman Jefferson's colleagues apparently agree with him and have added their names as cosponsors of his legislation. While we urge this Congress to address this important issue and pass H.R. 2273, we continue to believe that the GPO unfairly penalizes individuals who spend their careers in public service and should be repealed.

I want to share with this Committee the circumstances of two particular long-term federal employees who are negatively impacted by the Government Pension Offset.

Mrs. Joan Lonnemann has been a seasonal Internal Revenue Service employee at the Cincinnati, Ohio Service Center for 33 years. Although Mrs. Lonnemann is fully eligible to retire, she simply cannot afford to take that chance right now. Her husband, who is six years her senior, has already retired and currently receives Social Security. She currently receives her spousal Social Security benefit, based on her husband's earnings record, of \$512 per month. And, she is entitled to continue to receive her spousal Social Security benefit just as long as she continues working! If and when Mrs. Lonnemann is forced to retire, all but \$26 of that benefit will end.

As absurd as this sounds, these are the facts. If, as expected, she receives a monthly annuity for her 33 years of public service of approximately \$730 per month, her Social Security spousal benefit will be reduced by  $\frac{2}{3}$  of that amount, or \$486,

leaving her a Social Security spousal benefit of \$26. She is not entitled to Social Security benefits in her own right.

Surely, the Government Pension Offset was never intended to wreak this kind of havoc. Should Mrs. Lonnemann retire and her husband predecease her, she would be left to live on \$756 per month (\$730 plus \$26 in Social Security spousal benefits). Blindly applying a law such as the Government Pension Offset without regard to the economic hardship it causes is difficult to justify. This is precisely the situation Congressman Jefferson looks to rectify by passage of his legislation, H.R. 2273.

Another case that has been brought to my attention is that of Mr. Oliver Hall of Havertown, Pennsylvania. Mr. Hall worked for the federal government as a customs inspector for 35 years and was forced to retire after a severe stroke. His retirement annuity, based on his long career in public service, is a little over \$1400 per month. When Mr. Hall's wife retired in late 1997, he was told he would be eligible for spousal Social Security benefits based on her earnings record of \$452 per month.

Of course, Mr. Hall is not eligible for this spousal Social Security benefit because of the Government Pension Offset. The first he learned of this offset, however, was in a letter dated December 28, 1997 from the Social Security Administration. With very little in the way of explanation, Social Security states, "We are writing to let you know that you are entitled to monthly husband's benefits on claim number....we reduce Social Security benefits paid to husbands or wives if they also receive a government pension based on their own work...for this reason, we cannot pay you."

As you can imagine, this came as quite a surprise to Mr. Hall who has appealed this ruling to the Social Security Administration. Mr. Hall is hardly alone in being caught unaware of this offset. Many more federal employees will be caught similarly unaware and many more—especially women—will be forced into poverty as a result of the Government Pension Offset.

Again, thank you for holding this important hearing today and for shining some light on an issue that often catches federal retirees completely by surprise. We look forward to working with you to correct this inequity. Let's begin by passing H.R. 2273. Thank you very much.

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**Statement of Sally D. O'Hare, Retired Illinois High School Teacher, Palos Heights, Illinois**

Prior to my retirement in June, 1994, at age 64, I had been a high school mathematics teacher for 32 years. I taught in the private schools for eight years and then taught in the public schools for twenty-four years. I paid social security as a private school teacher. I also paid social security for 24 years as a public school teacher on income earned outside of the school year, and as a part-time counselor, and other part-time curriculum assignments.

I receive a pension from my 24 years as a public school teacher. My social security monthly check is reduced dramatically by the off-set regulation. If my husband predeceases me in death, which actuarially is quite likely, I would receive none of his social Security benefit as his widow. This is identified as a widow's penalty.

I am currently an independent contractor and have a part-time marketing job, in education. I must pay federal taxes, State taxes, and Social Security taxes on this income. I must pay the social security tax as an employer and as an independent contractor employee. I pay all of my taxes and no income is off the books, nor part of the underground economy. I will receive not one dime of the additional Social Security taxes I must pay from my current employment. This inequity needs to be corrected for those persons, such as my self who have fallen through the cracks. You are in a position to rectified this injustice for senior citizens, who are retired teachers and who elect to stay in the work force. I would welcome an opportunity to testify before your committee. Thank you for your spirited representation of this matter in our behalf.

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**Statement of Hon. George V. Voinovich, Governor, State of Ohio**

Thank you for the opportunity to provide written testimony for members of the House Ways and Means Subcommittee on Social Security.

As Governor of the State of Ohio, I strongly oppose the imposition by the federal government of mandatory Social Security coverage on state and local government employees.

Mandatory Social Security would be another example of the federal government imposing an unfunded mandate on state and local governments. If state and local governments raise tax revenues to maintain the current benefit structure of existing state retirement systems, the funding liability for Social Security would shift from the federal government to state and local governments.

**OHIO PUBLIC PENSION SYSTEMS**

State and local government employees originally were excluded from the Social Security system and were not permitted to join the program voluntarily until 1954. The State of Ohio took efforts to ensure that state and local public employees also were protected. In fact, the State created the State Teachers Retirement System in 1921 to provide financial security in retirement for the teachers of Ohio. The Public Employees Retirement System (PERS), Ohio's largest retirement system, also was formed before the creation of the Social Security system. PERS was established by Ohio's legislature in 1933 to provide needed benefits to qualified members and their beneficiaries. These benefits include: survivor, disability, lump sum death benefits, and supplemental health care coverage for a retiree who is 65 and is eligible for Medicare, in addition to retirement income.

There are now five public employee retirement systems in the state of Ohio:

- Public Employees Retirement System of Ohio (PERS)
- State Teachers Retirement System of Ohio (STRS)
- Police and Fireman's Disability and Pension Fund
- School Employees Retirement System (SERS)
- Ohio State Highway Patrol Retirement System

All of the State's systems were designed to meet the direct needs of the occupations served.

There are over 1.1 million active and retired members in Ohio's five retirement systems. Ninety-two percent of the State's public employees are not covered by Social Security. As the largest retirement systems, PERS is a multiple employer plan covering 3,700 state and local government units. PERS currently has 637,500 active and inactive members and benefit recipients.

All Ohio retirement systems included a defined benefit plan and are pre-funded through employee and employer contributions and investments income. The largest source of income of the systems is investment return. For example, Ohio law requires pension benefits under Ohio's systems to be financed over a 30 year working career. Benefits under STRS are funded over 27 years. In PERS, over 70 percent of disbursements come from investments. Earnings pay for 17 years of 26 years of expected payments under STRS. The concept of financing an employee's benefits over a working career provides intergenerational equity. It avoids the problem of current pensions being paid for by future generations. The systems have funded liabilities so that as the ratio of active members to benefit recipients decreases, contribution rates will not have to be increased to fund the same level of benefits.

The investment of the state retirements funds provides a tremendous amount of capital in the economy of Ohio and the nation, unlike Social Security funds which simply support other government programs.

The state and local pension plans were actuarially sound at their conception and remain so today. These systems are accepted, trusted, fiscally sound and provide excellent benefits for their members. There is no need to restructure the state and local retirement systems.

**IMPACT OF MANDATORY SOCIAL SECURITY**

Mandatory Social Security would result in a drastic restructuring or abandonment of many excellent state and local retirement programs.

Financially strong, well-funded state and local retirement systems will be reduced to unstable pension systems. Current active members and retirees will suffer benefit

reductions and loss of help with health care costs causing the systems to break the social contract we have with our members.

In Ohio, a response to mandated Social Security for State of Ohio employees would rest with the General Assembly to enact legislation to change public employee benefits. If the General Assembly would choose to take no action to change Ohio statute, the added burden of the cost of FICA contributions would rest on public employees and employers at a rate of 6.2% for each group. Adding the full cost of the FICA tax to the state retirements system taxes would create an enormous unfunded mandate for the state and localities.

If the General Assembly would choose to add no new costs to employers and employees, future investment fund flows would be reduced to make FICA payments. The remaining contributions would be used to provide a level of benefits within those contribution levels. This approach would necessitate a reduction of benefits to public employees. Changes to the program could include the elimination of health care for participants, including retirees; elimination of death, disability or survivor benefits; or reducing cost of living adjustments.

The General Assembly also could take the position that the current levels of benefits would be maintained by integrating state retirement plan and Social Security benefits. If this scenario were adopted, additional costs for the PERS, for example, likely would be in the range of six percent to seven percent of covered payroll, especially if there were a continuation of some meaningful retiree health benefits. Without post-retirement health care programs, an enormous burden will be shifted to the Medicare and potentially the Medicaid programs.

Under the second and third scenarios, reduced cash flow into the systems will result in a lower amount of funds to invest. Since investment earnings are a vital part of pension financing, the reduction will cause a longer funding period (up to 40 years in the estimate of STRS).

In addition, public plan benefits are tailored to specific subsets of all workers. Social Security does not address the special needs of our uniformed employees. Disability, which accounts for 25 percent of Police and Fire retirements, is not provided by Social Security unless one is totally unemployable for any job. Partial disabilities, which encompass 79 percent of Police and Fire disability retirements with awards ranging from five percent to 60 percent of salary, are not covered by Social Security. Also, the nature of Police and Fire work requires early retirement, when Social Security is not yet available.

Increased contribution rates or reduced benefits also could hurt the recruiting and retention of public employees. Many public employees receive lower pay but better benefits than their private sector counterparts. Removing the benefit incentive will entice many employees to seek employment in the private sector.

Practically speaking, mandatory Social Security would cause employee rates to increase or employee benefits to decrease. Public employees are fully and immediately vested in their own contributions. This is not the case with Social Security. Ohio public employees would be forced to participate in a poorly funded system with future benefits at risk. Mandatory Social Security taxes likely will cause states, especially Ohio, to reduce or eliminate the funding of post retirement health care programs—shifting an enormous burden to Medicare programs.

Any change to state programs would result in significant administrative cost increases, as well. The state would need to change publications, computer systems, benefit processing, and member education efforts, just to name a few.

History has shown that Social Security calculation of benefits and corresponding revenues is faulty. The small transition funds received from mandating coverage will not fix the basic problems with Social Security, and in the long-run the new obligation may offset the added revenue. If the benefits for current beneficiaries and current participants cannot be fiscally met, then the infusion of more participants simply exacerbates the problem. The result will be the destruction of secure long-standing state pension funds for very little gain and lesser benefits for public employees.

#### CONCLUSION

I believe that it would not be prudent to alter the funding of Ohio's public employee retirement systems that are solvent, stable systems. Mandating that public employees covered by the public pension systems in Ohio and other states participate in Social Security is flawed public policy. It would cause great harm to systems which pre-date social security and cause the systems to break promises made to their members for little or no material help to Social Security.

I respectfully urge your opposition to any attempt to require state and local employees to participate in Social Security. Thank you for your consideration of my concerns.

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**Statement of Hon. Max Sandlin, a Representative in Congress from the  
State of Texas**

Thank you Mr. Chairman and Ranking Member Rangel, for the opportunity to testify today on the impact of the Windfall Elimination Provision on the Social Security benefits of retired government employees. I appreciate the committee including both the Government Pension Offset and the Windfall Elimination Provision in the debate on the future of Social Security.

I would like to echo the testimony given by my colleagues, Mr. Frank and Mr. Jefferson, regarding their respective bills. Both bills are worthy of consideration by this committee. I have cosponsored the bill by Mr. Jefferson and support full Social Security widow's benefits for former government employees. I also support the legislation introduced by Mr. Frank, which addresses the Windfall Elimination Provision, on which I am about to testify.

Mr. Chairman, just like many of my colleagues on this committee, I spend time virtually every weekend traveling through my district visiting with my constituents. From every corner of the 19 counties in the First Congressional District of Texas, I have heard from former local, state and federal government employees who have been surprised by the paucity of their Social Security benefits due to the Windfall Elimination Provision, enacted in 1983.

One of these constituents happens to be my mother, whose suggestions and advice I have learned over many years not to ignore. My mother was happy to spend nearly 30 years serving society as a public school teacher, a job which simultaneously challenged and fulfilled her. However, she never expected that her reward for these years of service would be a significant reduction in her Social Security benefits. She, like many of the 290,000 government retirees affected by this provision, feels like the federal government has turned its back on her when she needs its help the most—during her retirement years.

The Windfall Elimination Provision was enacted in 1983 to help restore solvency to the program and correct a perceived inequity in the treatment of people who had worked both in jobs covered by Social Security and jobs exempted from Social Security. Mr. Chairman, I understand the history of and the rationale for the Windfall Elimination Provision. It may be true that due to a flaw in the Social Security formula, prior to 1983 some retirees eligible for both Social Security benefits and a local, state, or federal government pension received a larger-than-justified benefit. I don't think anyone in this hearing room wants to be giving undeserved benefits to retired government employees who also spent time in the private sector. However, I also don't think anyone in this room believes we should now punish these teachers, firemen, and policemen with Social Security benefits that fail to meet their expectations, fail to provide them with a basic standard of living, and fail to fulfill the agreement they have made with the federal government.

Some claim that this provision is not particularly onerous to many of the affected retirees because the provision generally affects only those who are well off and have a generous government pension. I assure the members of this committee that my mother, for one, is not one of the retirees who feel this provision is not particularly onerous. She spent much of her life in public service and planned her retirement carefully. To have had her Social Security benefits arbitrarily and unexpectedly reduced was more than just an insult—it was also a lowering of her standard of living in her retirement years.

According to a 1990 CRS report, the Windfall Elimination Provision "is appropriate for typical CSRS annuitants, but over-penalizes lower-paid workers with short or fairly evenly split careers, and under penalizes workers with long Social Security-covered careers." I appreciate the work Mr. Frank has done on addressing the impact of the Windfall Elimination Provision on low income retirees. His bill partially repeals the Windfall Elimination Provision for government employees with small pensions. I think this may be one very effective way of restoring benefits to those who most need them and who may be disproportionately affected by this provision.

However, I have introduced a bill, H.R. 3077, the Social Security Benefit Restoration Act, to repeal the Windfall Elimination Provision and restore equity and fairness to the Social Security benefits of our retired government employees. I introduced this bill calling for the complete repeal of the Windfall Elimination Provision

because I believe the provision is unfair to any retired government employee, regardless of his or her financial status.

This bill would put our federal government back in the business of providing our retired government employees with the retirement security they deserve. I recognize that full repeal of the Windfall Elimination Provision would be expensive, and we need to debate a reasonable way to pay for this legislation. However, this bill would not be creating a new benefit, only restoring a benefit that retirees once had. I don't think this means the bill should be exempt from pay-go rules, but it does mean that it should be part of any debate on Social Security reform. As Congress moves forward with reform of the Social Security system, Mr. Chairman, I urge you and the members of this committee to remember our retired federal, state, and local government employees and seriously consider repeal of the Windfall Elimination Provision.

I would like to close, Mr. Chairman, by reading you a portion of a letter from a constituent. This constituent writes:

"From day one of my employment, I was always told that someday I would be glad the withholding from my check for Social Security would be there for me at retirement. That was always in my plan for retirement. Now a significant amount of what I was promised is being withheld from my check. Just at a time in my life when I am very likely to need extra funds for health care and to maintain a fair standard of living it is being taken away. This is unfair to us seniors."

Thank you Mr. Chairman, Ranking Member Rangel, and members of this committee.

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STATE TEACHERS RETIREMENT SYSTEM OF OHIO

*May 13, 1998*

Mr. A. L. Singleton, Chief of Staff  
U. S. House of Representatives  
Committee on Ways and Means  
1102 Longworth House Office Bldg.  
Washington, D. C. 20515

Dear Mr. Singleton:

These comments are being submitted on behalf of the State Teachers Retirement System of Ohio Board of Trustees and the more than 300,000 active and retired members of our system for the printed record of the Subcommittee on Social Security of the Committee on Ways and Means hearing on "The Future of Social Security for this Generation and the Next."

Ohio has a long history, predating Social Security, of providing retirement and disability security and family income to state and local public employees. When Social Security was initiated in the mid-1930s by Congressional action, Ohio public employees were not permitted to participate. Later, when states were given the option of joining Social Security, Ohio voted to remain independent. Ohio public servants were already well served. The Ohio public retirement systems were and are stable and working well.

After carefully studying the January 6, 1997 Advisory Council on Social Security report and analyzing the actuarial impact both in terms of increasing costs and reducing benefits to the members of our system, we stand strongly opposed to any proposal that would require mandatory participation in Social Security. We respectfully urge your determined opposition to any proposal that would mandate coverage for any non-covered system.

The soundness of Social Security for the future is a very important issue for the nation. However, mandating participation is not the solution; it provides no long-term fiscal benefits to Social Security, but causes permanent and serious damage to plans like STRS and those like us throughout the nation.

Unlike Social Security which is a pay-as you-go system, STRS is 83% reserve funded. Member and employer contributions, along with income from investments, provide the reserves needed to finance retirement benefits. Investment income provides 65% of the funds for benefit payments.

It would be a serious mistake to believe that those public employees who remained in public pension funds would not be adversely affected by mandatory coverage for new hires. Faced with the added cost of Social Security, it is certain that over time Ohio would be forced to change existing public pension plans by adjusting benefits downward as well as dropping retiree health care. The impact of reducing contributions to public plans by more than half in most systems would reduce the



capital stream necessary for investment and could force such plans to cut back on benefits for all members. There is no way that states can deal with an unfunded mandate of such immense proportions.

In restructuring the Social Security system, we believe that consideration should be given to what non-covered systems have done well in providing for our members. The area of investments alone provides great potential for restructuring Social Security. Simply adding more members which has never worked in the past, and which will not work now, is not the answer.

We appreciate the opportunity to comment on this important issue and would be pleased to provide further information if that would be helpful to you. Thank you for your consideration.

Respectfully,

HERBERT L. DYER  
*Executive Director*

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TEACHERS' RETIREMENT SYSTEM OF KENTUCKY  
*June 3, 1998*

Representative Jim Bunning  
Chair, House Social Security Subcommittee  
2437 Rayburn Building  
Washington, D.C. 20515

Dear Congressman Bunning:

I wish to comment on the proposal to mandate Social Security participation for all new public employees that is under consideration in the House Social Security Subcommittee. As you know, the retirement benefits of public school teachers and administrators in Kentucky are provided exclusively by the Kentucky Teachers' Retirement System which has more than 75,000 members.

The Kentucky General Assembly has acted over a period of years to establish an excellent level of benefits for public school teachers. While enhancing the recruitment and retention of qualified teachers, the benefit program also recognizes that the current demands placed on teachers make it beneficial to the State and the teachers to provide meaningful benefits at ages several years prior to age 65 or the extended ages planned by Social Security.

Unlike the Social Security program which operates on a pay-as-you-go basis, the Commonwealth has acted responsibly by funding the cost of the program on an actuarial reserve basis from contributions made by active members and the State. The June 30, 1997 actuarial valuation by an independent actuary reflects that the current total contribution rate of 19.81 percent of active member payroll plus reserve funds and investment income will be sufficient to pay all benefits earned by retired and currently active members. Members contribute 9.855 percent, and the State matches the member contribution plus an additional 3.25 percent to retire the System's unfunded obligations with the contributions totaling 22.96 percent, 3.15 percent of which is allocated for a comprehensive health insurance plan for retirees. The current levels of funding allow the System to maintain reserve trust funds that assure the actuarial and financial soundness of KTRS.

Buck Consultants, the System's Actuary, has stated that if the current 22.96 percent contribution rate to KTRS is reduced by 12.4 percent due to mandated Social Security, the KTRS benefit accrual formula per year of service by public school teachers would have to be reduced from 2.5 percent to

less than 1.0 percent. The reallocation of 12.4 percent from the KTRS is a distinct possibility since it would be improbable that members or the State could contribute an additional 12.4 percent of payroll, and the choice would be either large increases in contributions or significant reductions in KTRS benefits now available to all KTRS members. An illustration identifies the negative impact on an average teacher. Under current KTRS laws, a new teacher would receive 83 percent of their average salary at age 55 after teaching 33 years. If the KTRS funding is reduced by 12.4 percent to accommodate Social Security coverage, the KTRS benefit for the same new teacher would be less than 33 percent at age 55, and they would have to wait at least ten years to be eligible to receive Social Security.

Most would agree with the GAO finding that mandatory coverage would benefit the financially troubled Social Security program. The program would receive an additional 12.4 percent of salaries of newly hired public school teachers and other pub-

lic employees for a period of 40 plus years before having to make any payments to most of the teachers and other government employees. I understand that the Social Security actuaries estimate that the savings resulting from mandatory coverage would be hundreds of billions of dollars over the next 75 years, but the saving for Social Security would represent funds lost by the newly covered employees and their employers, such as the state of Kentucky.

It appears that the reason such a blatant and unwarranted transfer of wealth could even be considered results from too much attention to actuarial funding and not enough recognition of the fact that Social Security is almost a pure pay-as-you-go system where today's active workers support today's retirees. It also appears the reason for this proposal is not to protect the retirement benefits of future state and local employees, but to use their current contributions to help solve the Social Security deficit problem.

I have read the statements made at the May 21, 1998 meeting of the House Social Security Subcommittee by the Executive Directors of three state pension plans, Colorado, Ohio and Nevada. The makeup of those public pension plans is very similar to that of the Kentucky Teachers' Retirement System, and rather than repeat their positions, I submit that their findings and recommendations are typical of the public plans that would be affected by mandatory Social Security coverage.

In conclusion, it is the position of the Kentucky Teachers' Retirement System that mandatory Social Security coverage would impose significant negative impact on Kentucky's teachers who would either contribute an additional 6.2 percent for Social Security or have their KTRS benefits reduced more than half of the current level. The choice of the state of Kentucky would be increase taxes to pay the additional 6.2 percent employer payment required for Social Security or reduce the KTRS benefits. With 12.4 percent of contributions allocated to Social Security, the KTRS would lose multimillion of dollars each year due to a loss of income from investments, a source of income that funds over 60 percent of the annuities paid to retirees.

Congressman Bunning, we ask that you consider the serious consequences that mandatory coverage would place on Kentucky's future teachers and the necessity of the State having to increase taxes or dismantling of a retirement system that has provided meaningful benefits to Kentucky's teachers since 1940. We need your help on this very important issue.

Please advise if you would like additional information pertaining to the Kentucky Teachers' Retirement System and its members.

Sincerely,

PAT N. MILLER  
*Executive Secretary*

